Ceres
Sustainability is the bottom line.

July 30, 2020

VIA ELECTRONIC FILING

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: RIN 1210-AB95, *Financial Factors in Selecting Plan Investments* proposed rule

Dear Assistant Secretary Wilson,

I am writing regarding the Department of Labor Employee Benefits Security Administration's proposed rule, *Financial Factors in Selecting Plan Investments*, Regulatory Identifier Number (RIN) number 1210-AB95.

Ceres is a nonprofit organization working with institutional investors and companies to build sustainability leadership and drive solutions throughout the economy. We support the Investor Network on Climate Risk and Sustainability, which consists of over 175 institutional investors managing more than $29 trillion in assets, who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres has worked closely with institutional investors since our founding in 1989, and with an expanding group of investors since the founding of our Investor Network 17 years ago.

I am concerned that the proposed rule would undermine fiduciaries from assessing and managing financially material environmental, social and governance (ESG) risks and opportunities in their investments. Members of our Investor Network have found that evaluating ESG issues provides a clearer picture of financial risks in their portfolios, enabling them to pursue a range of strategies to reduce those risks, including ESG integration in analysis and investment decisions, investing in companies with superior ESG performance, corporate engagement, and advocating for policy and regulatory solutions.

I urge the Department to withdraw, or in the alternative, substantially modify the proposed rule. Specifically, I call on The Department to: (1) Acknowledge that ESG issues may in fact pose material short, medium and long term financial impacts and risks; (2) Clarify that when ESG issues present material risks or opportunities, the fiduciary duties under the U.S. Employee Retirement Income Security Act of 1974, as amended (ERISA), would compel qualified investment professionals to treat such ESG issues as economic considerations; (3) Retain the "tie-breaker" test, which allows for ESG factors to be considered for *non-pecuniary* reasons; and

(4) Rely upon its existing, protective framework in whether a ESG fund (pecuniary or non-pecuniary) may constitute a QDIA or component of a QDIA.

(1) ESG issues pose short, medium and long term financial impacts and risks

The proposed rule reflects an outdated and inaccurate view that ESG factors are non-financial and considering them can lower returns. The opposite is true. The evidence is clear that ESG issues pose short, medium and long term financial impacts and risks that place them squarely within the category of material, financial risks that are factored into investment decisions. These impacts range from significant to highly material, with certain ESG issues posing systemic risks. A prudent fiduciary should keep this evidence in mind as a part of their analysis. The Department should clearly acknowledge that ESG issues may in fact pose material short, medium and long term financial impacts and risks to companies and investments.

<u>Evidence is clear that ESG issues pose short, medium and long term financial impacts and risks to companies and financial markets</u>

Consequences of climate change provide clear evidence for the financial impacts and risks of ESG issues. For example, extreme weather events, made more frequent and severe by climate change, have led to mounting economic impacts. Since 1980, the U.S. has sustained more than 265 climate change-amplified extreme weather events with losses exceeding $1 billion, causing total costs exceeding $1.775 trillion. From 2015 to 2019, direct economic losses totaled more than $500 billion. These risks and losses are increasing as climate change and related physical impacts (e.g., sea level rise, extreme precipitation, stronger storms, flooding, heat waves, droughts) accelerate.[1]

Physical risks from rising global temperatures, which have increased 1.8° F since the mid-twentieth century, are the most immediate risk to the U.S. economy. Significant economic losses are projected for the years ahead. The U.S. Fourth National Climate Assessment suggests that unmitigated climate change could contract the U.S. economy by as much as 10% annually by the year 2100.[2] A 2019 analysis of 215 of the world's largest companies identified just under $1 trillion of potential risk to them from climate change – and noted that half of these losses are expected to materialize in the next five years.[3]

The longer it takes the U.S. to embrace the ongoing global transition to a net-zero carbon economy, the greater will be the future losses from the physical impacts of climate change. Doing so also neglects incredible opportunities for U.S. companies and employees to play a leading role in innovation and benefit by creating a wealth of opportunities for investors and spurring economic growth. Sectors that are critical to our economy – including energy, transportation, agriculture, banking and insurance – are particularly vulnerable to climate risks

[1] Ceres, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators* (June 2020) at 1. Available at https://www.ceres.org/regulating-climate-financial-risk.
[2] Id. at vii.
[3] CDP, *World's biggest companies face $1 trillion in climate change risks*, June 4, 2019. Available at https://www.cdp.net/en/articles/media/worlds-biggest-companies-face-1-trillion-in-climate-change-risks.

and a poorly planned transition. These risks have already led to price volatility, competitiveness impacts, and asset losses.[4]

The transition away from fossil fuels could cause major disruptions and reduced valuations for the carbon-intensive assets that underpin much of today's U.S. economy - and in many cases it already has. Given the massive size of these industries – as much as a third of all equity and fixed income[5] assets are tied to carbon-related extraction and carbon-intensive industries such as utilities, transportation, chemicals, and industrial goods – these cumulative losses could have deep negative impacts on major financial institutions and other financial intermediaries holding these devalued assets. Some economists are concerned that if these changes strike lenders and investors quickly, the value of carbon-related assets could suddenly decline,[6] severely damaging asset values and bank balance sheets. Net exporters of fossil fuels, such as the U.S., are projected to fare poorly in this scenario.

Investments in long-lived carbon-intensive assets – such as oil and natural gas reserves – would be stranded if they are retired before the end of their productive lifespans, thereby creating financial losses.[7] A major drop in oil demand and oil prices, driven by a global low carbon transition, may cause the "carbon bubble", built on capital investments with a long lifespan, to burst. According to a 2018 study, the equivalent of between $1 trillion to $4 trillion could be removed from the global economy in fossil fuel assets alone in the next 15 years.[8] Another estimate that takes a broader view of stranded assets, assuming a later and more abrupt transition scenario, puts the value of potential losses as high as $20 trillion.[9]

Other ESG issues, such as water availability and quality, also pose profound financial risks. By 2030, global demand for water is expected to exceed supply by 40 percent, and 663 million —one in ten people — already live without access to safe water. Some regions, like East Asia, the Middle East and Central Africa, could see as much as a 6 percent contraction in GDP by 2050 due to water-related impacts on agriculture, health, and incomes. Water-related risks to

[4] *Addressing Climate as a Systemic Risk* at 3.

[5] *Addressing Climate as a Systemic Risk* at 10, citing Tooze, Adam, *Why Central Banks Need to Step Up on Global Warming*, Foreign Policy, July 20, 2019 (https://foreignpolicy.com/2019/07/20/why-central-banks-need-to-step-up-on-global-warming/).

[6] *Addressing Climate as a Systemic Risk* at 10, citing Mercure, J.F., et al., "Macroeconomic Impact of Stranded Fossil Fuel Assets", Nature, June 4, 2018 (https://www.nature.com/articles/s41558-018-0182-1).

[7] *Addressing Climate as a Systemic Risk* at 10, citing "Oil and Gas Companies Approve $50 Billion of Major Projects that Undermine Climate Targets and Risk Shareholder Returns", Carbon Tracker Initiative, September 5, 2019 (https://carbontracker.org/oil-and-gas-companies-approve-50-billion-of-major-projects-that-undermine-climate-targets-and-risk-shareholder-returns/); Coffin, Mike and Grant, Andrew, "Breaking the Habit: Why None of the Large Oil Companies are 'Paris-Aligned', and What They Need to Do to Get There", Carbon Tracker Initiative, September 2019 (https://carbontracker.org/reports/breaking-the-habit/).

[8] *Addressing Climate as a Systemic Risk* at 10, citing Mercure, J.F., et al. "Macroeconomic Impact of Stranded Fossil Fuel Assets." Nature. June 4, 2018.

[9] *Addressing Climate as a Systemic Risk* at 10, citing Tooze, Adam. "Why Central Banks Need to Step Up on Global Warming." Foreign Policy. July 20, 2019

business have material impacts on—or pose material risks to—investors, from underperformance of investments to increasing volatility and risks across entire asset classes.[10]

Water risks are driven by competition for water, inefficient water use, weak regulation, growing population, aging infrastructure, water contamination and climate change. The most significant risks are physical, regulatory and social, referring primarily to the social license to operate.[11]

One example of the manifestation of these risks to industry is growing water risks to agricultural commodity supply chains. Approximately 70 percent of freshwater is used to grow crops, feed livestock and process ingredients. By 2050, in order to meet the needs of a projected population of 9.7 billion, global water demands are expected to increase by 55 percent and food demands by 60 percent.[12]

Food and beverage companies are particularly vulnerable to these risks, including higher commodity price volatility and decreasing reliability of supplies. An MSCI analysis of food companies in its All Country World Index (ACWI) found that $459 billion in revenue may be at risk from lack of water available for irrigation or animal consumption, and $198 billion is at risk from changing precipitation patterns affecting current crop production areas.[13]

Beyond environmental issues, social issues can likewise pose material financial risks. There is substantial and growing evidence that human rights issues, which encompass workers' rights and diversity and inclusion strategies, pose financial impacts and risks to companies. Depending on the sector and a company's specific businesses, these impacts may materialize in different parts of global value chains (raw commodity sourcing, manufacturing and distribution, operations and retail, and product use), requiring investors to analyze these risks and engage with portfolio companies to understand them.

A 2018 report found that companies with poor human rights practices face risks including workplace injuries and illnesses, high turnover, and a greater chance of facing employee-related litigation. Companies also face lost opportunities if they are not able to take advantage of government incentives related to human rights, including procurement, export credit support, and trade incentives. Finally, human rights litigation is expanding and poses financial and reputational risks.[14]

In addition, studies of employment conditions found that firms that treat their workforce poorly suffer a host of negative consequences, including: weaker access to human capital; higher

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[10] Ceres, *Investor Water Toolkit: A Project of Ceres Investor Water Hub*, December 5, 2017 at 5 (https://www.ceres.org/resources/toolkits/investor-water-toolkit).
[11] *Investor Water Toolkit* at 8.
[12] *Investor Water Toolkit* at 13.
[13] MSCI, *Food Products Industry Report* (February 2017).
[14] Dr. Başak Bağlayan, Ingrid Landau, Marisa McVey & Kebene Wodajo, *Good Business: The Economic Case for Protecting Human Rights*, December 2018 at 18 (https://www.researchgate.net/publication/329828724_Good_Business_The_Economic_Case_for_Protecting_Human_Rights).

turnover (and associated financial costs of such instability); and decreased trust and innovation.[15] Similarly, McKinsey & Company has consistently found that companies with higher rates of racial and gender diversity outperform their peers, concluding most recently in 2020 that companies in the top quartile for gender diversity on executive teams were 25 percent more likely to have above-average profitability than companies in the third quartile—up from 21 percent in 2017 and 15 percent in 2014.[16] In regard to global supply chains, a study on the impact of conflict with local communities shows that it leads to significant opportunity cost for companies in regards to future projects, project expansion, and sales.[17]

<u>Investors have identified ESG issues that are material for every industry sector</u>

Numerous firms, such as BlackRock, State Street Global Advisors, MSCI, and Sustainalytics, have analyzed the materiality of ESG issues to many industries, finding risks in every sector. For example, over a six year period the Sustainability Accounting Standards Board (SASB) analyzed the materiality of ESG issues in 77 industries. The investor consultation was extensive, with more than 2,800 individuals – affiliated with companies, and with investors representing $23.4 trillion in assets under management – participating in industry working groups.[18] The purpose was to develop standardized accounting metrics to better track and disclose ESG risks and improve analysis of these risks.

SASB found ESG issues that were likely to be material in each industry, with an average of six ESG topics for each industry.[19] In many cases, a particular ESG issue is material to many industries. For instance, SASB found climate change was likely to be material in 72 out of the 77 industries it covers, covering 93% of the U.S. equities by market capitalization.[20]

Universal asset owners and asset management firms have issued letters to CEOs, boards of their portfolio companies and governments calling on them to address climate change and other ESG issues – from their perspectives as investment fiduciaries for their clients and beneficiaries. The 2020 letter from Blackrock CEO Larry Fink to CEOs and boards of its portfolio companies noted climate change "has become a defining factor in companies' long-term prospects. … In the near future – and sooner than most anticipate – there will be a significant reallocation of capital."[21]

[15] Casey O'Connor, Sarah Labowitz, NYU Stern Center for Business and Human Rights, *Putting the "S" in ESG: Measuring Human Rights Performance for Investors*, March 2017 (https://www.stern.nyu.edu/experience-stern/global/putting-s-esg-measuring-human-rights-performance-investors).
[16] Vivian Hunt, Sundiatu Dixon-Fyle, Sara Prince, Kevin Dolan, McKinsey & Company, *Diversity Wins: How Inclusion Matters*, May 2020 (https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters).
[17] *Putting the "S" in ESG: Measuring Human Rights Performance for Investors.*
[18] SASB, 2016 Consultation Guide, available at https://www.sasb.org/?s=consultation+guide (accessed July 6, 2020).
[19] SASB, *Response of the Sustainability Accounting Standards Board to the Public Consultation on the Revision of the Non-Financial Reporting Directive* at 5 (https://www.sasb.org/wp-content/uploads/2020/06/SASB.NFRDWhitepaper.FINAL-005.pdf).
[20] SASB, *Climate Risk Technical Bulletin*, October 2016 at 8-9 (https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/).
[21] BlackRock, *A Fundamental Reshaping of Finance* (https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter); see also BlackRock's letter to clients,

Some ESG issues pose systemic risks to financial markets

Some ESG issues pose systemic risks to financial markets. For instance, in addition to the climate change-related impacts and risks discussed above, climate change also poses systemic risks to the stability of U.S. and global financial markets. Systemic risks are those that have the potential to destabilize capital markets and lead to serious negative consequences for financial institutions and the broader economy.[22]

Under this definition, climate change, like the current COVID-19 crisis, is indisputably a systemic risk. Its wide-ranging physical impacts, an accelerating transition to a low carbon economy, and other socio-economic ripples are likely to manifest in both cumulative and unexpected ways and present clear systemic risks to U.S. financial markets and the broader economy. If U.S. investors, companies and governments do not improve their management of these risks, they could have significant, disruptive consequences on asset valuations, global financial markets and global economic stability.[23] Many investors recognize this, which led 631 investors managing over US $37 trillion to sign the Global Investor Statement to Governments on Climate Change, which called on world governments to commit to improve climate-related financial reporting by companies and take other steps to reduce climate risks and expand related investment opportunities.[24]

In the long term, climate change poses debilitating systemic risks if not aggressively addressed. As the consulting firm Mercer recently reported:

> Investors such as pension funds, insurers, wealth managers, and endowments and foundations typically have multi decade time horizons, with portfolio exposure across the global economy. The implications of climate change are systemic and are already apparent. We have already experienced around 1°C of average warming above pre industrial levels, and extraordinary weather events with significant financial and human consequences are increasing in frequency. Humans have never lived in a world much warmer than today; yet the current trajectory of at least 3°C above the preindustrial average by 2100 could put us beyond the realm of human experience sometime in the next 30 years.[25]

Financial regulators and their associations globally have recognized systemic and material ESG risks in recent years and begun acting to address them. A 2019 survey of 33 central banks and supervisory authorities, collectively representing 77% of global GDP, found that 70% of them

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Sustainability as BlackRock's New Standard for Investing (https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter).

[22] *Addressing Climate as a Systemic Risk* at vi.

[23] *Addressing Climate as a Systemic Risk* at vi.

[24] Global Investor Statement to Governments on Climate Change (https://theinvestoragenda.org/focus-areas/policy-advocacy/).

[25] Mercer, *Investing in a Time of Climate Change: The Sequel 2019* (2019) at 6 (https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html).

saw climate change "as a major threat to financial stability," and showed more than half are already acting to monitor and address climate risk.[26] IOSCO, the Central Banks and Supervisors Network for Greening the Financial System (NGFS), the Financial Stability Board and others have initiatives examining climate and/or sustainability risks, and governments in the UK, Australia, and Europe are taking action.[27] [28] [29] [30] The NGFS currently has 66 members, representing central banks and supervisors worldwide.[31]

The US financial regulatory community is also beginning to follow suit. In 2019, the Federal Reserve Banks of Dallas and St. Louis have examined the risks of losses in their regions from climate change. The San Francisco Federal Reserve Bank has written about climate risks which are "relevant considerations for the Federal Reserve in fulfilling its mandate for macroeconomic and financial stability." The Commodity Futures Trading Commission created a Climate-Related Market Risk Subcommittee to provide a report identifying and examining climate related financial and market risks throughout the U.S. economy. SEC Chairman Jay Clayton has spoken about the importance of human capital management and other sustainability risks, and the Commission has published multiple guidance documents and issued statements about the importance of COVID-19 related risks assessment and disclosure by issuers.[32]

Ceres' report, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators,* identifies over 50 specific recommendations for actions that federal and state

[26] *Addressing Climate as a Systemic Risk* at 2.

[27] The Bank of England has announced plans for mandatory stress tests of the resilience of major U.K. banks and insurers on a range of climate scenarios. "Bank of England Consults on its Proposals for Stress Testing the Financial Stability Implications of Climate Change." Bank of England. December 18, 2019 (https://www.bankofengland.co.uk/news/2019/december/boe-consults-on-proposals-for-stress-testing-the-financial-stability-implications-of-climate-change); "Discussion Paper: The 2021 Biennial Exploratory Scenario on the Financial Risks from Climate Change", Bank of England, December 2019 (https://www.bankofengland.co.uk/paper/2019/biennial-exploratory-scenario-climate-change-discussion-paper).

[28] The Australian Prudential Regulation Authority plans to introduce mandatory stress tests of the country's banks, insurers and the pension fund industry to better understand climate impacts on the Australian economy. Summerhayes, Geoff. "Understanding and Managing the Financial Risks of Climate Change." Australian Prudential Regulation Authority. February 24, 2020, https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change.

[29] In 2019, the European Securities and Markets Authority issued technical advice outlining how fund managers should disclose how they integrate ESG risks in investment decisions, as well as their methodologies for measuring the ESG impacts of investments and products. "ESMA's Technical Advice to the European Commission on Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD." European Securities and Markets Authority, April 30, 2019, https://www.esma.europa.eu/sites/default/files/library/esma34-45-688_final_report_on_integrating_sustainability_risks_and_factors_in_the_ucits_directive_and_the_aifmd.pdf.

[30] In February 2020, the U.K. government released a proposal that would require pension funds to disclose how they integrate climate change across their governance, strategies and risk management. "Pension Schemes Bill [HL]: Running List of Amendments in Grand Committee." United Kingdom Parliament, February 13, 2020, https://services.parliament.uk/Bills/2019-21/pensionschemes/documents.html.

[31] https://www.ngfs.net/en/about-us/membership.

[32] See SEC Coronavirus (COVID-19) Response, Guidance and Targeted Regulatory Assistance and Relief, available at https://www.sec.gov/sec-coronavirus-covid-19-response.

financial regulators could take to address climate risks. Regarding the Department of Labor, the report encourages the Department to collaborate with the Securities and Exchange Commission:

> Supporting the ability of investors to engage on climate risks with their portfolio companies in an unimpeded manner would align with the SEC's mission to foster "fair, orderly and efficient markets." In the same vein, the Department of Labor should initiate an inter-agency process with the SEC to clarify the right of pension fund trustees and administrators to integrate ESG factors such as climate change into their investment decisions.[33]

The proposed rule, by contrast, would harm the abilities of trustees and administrators to integrate ESG factors into their investment decisions, and it is contrary to the critical trend of regulators analyzing and helping market participants address ESG risks.

Finally, it is worth emphasizing how climate risks are particularly threatening to beneficiaries, industry sectors, and the U.S. economy. Climate change presents known, probable, and material risks to asset valuations across sectors and geographies. Coastal storm damage and the revaluation of fossil fuel companies are early examples of these impacts, and will prove small relative to future losses.

Regarding effects on the U.S. economy, as the US government continues to lag the rest of the developed world in embracing the transition to renewable energy, we are falling behind in the race to develop new technologies, skillsets and infrastructure that will prove critical to economic competitiveness and growth in years to come. This will come at a cost not only to investors in U.S. equities, but to our workforce, who will not have access to jobs in these growth industries.

Retirement savers generally own a broad diversified portfolio and are long term investors. While short term investors may profit by investing in companies that degrade the environment, such investments present risks not only in and of themselves, but over the course of time to a wide array of companies and sectors future retirees are also invested in. The interests of participants and beneficiaries are clearly served by maximizing the financial value of their retirement savings and mitigating material financial risks, but they are also served by protecting the world they live in so that they are able to enjoy their retirement free from the catastrophic effects of climate change.

(2) The Department needs to clarify that, when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to consider them.

The Department needs to more clearly state, especially in the actual final regulation (should the Department move forward with this proposed rule), that when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to treat such ESG issues as economic considerations under generally accepted investment theories.

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[33] *Addressing Climate as a Systemic Risk* at 30.

ESG investments, on average, provide comparable or superior returns to non-ESG investments

The largest meta-study to date on the relation between ESG criteria and corporate financial performance (CFP) examined over 2,200 empirical and review studies. It found that the business case for ESG investing is "empirically very well-founded" (investing in ESG "pays financially"), with "approximately 90% of studies find a nonnegative ESG–CFP relation."[34]

The study found that the positive ESG impact on corporate financial performance is stable over time.[35] Finally, it found that "ESG outperformance opportunities exist in many areas of the market", in particular North America, emerging markets, and non-equity asset classes.[36] Recent studies by S&P,[37] Morningstar,[38] and BlackRock[39] provide further evidence of this ESG outperformance.

U.S. investors are already considering ESG in engagement and investment decisions

It is currently a common, mainstream practice for U.S. institutional investors to consider ESG (or "sustainability") factors in their corporate engagement practices and engagement and investment decisions. The 175 institutional investors in the Ceres Investor Network, managing more than $29 trillion in assets, pursue this practice. In the U.S., sustainable investing's growth rate surpassed 38 percent from 2016 to 2018. According to US SIF, "more than one out of every four dollars under professional management in the United States today—26% of the $46.6 trillion in total assets under management tracked by Cerulli Associates—is involved in sustainable investing."[40]

The UN Principles for Responsible Investment Initiative (PRI) has over 3,000 signatories globally; 96% of their asset owner signatories have a mission, strategy or investment policy referencing responsible investment (i.e., investment that considers ESG factors) that covers the majority of their assets under management.[41] Eighty-nine percent of global institutional investors say they will request sustainability (ESG) information directly

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[34] Friede, Gunnar and Busch, Timo and Bassen, Alexander, *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies,* Journal of Sustainable Finance & Investment, Volume 5, Issue 4 (October 2015) at 210, 212, 217 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610).
[35] *ESG and Financial Performance: Aggregated Evidence* at 212.
[36] *ESG and Financial Performance: Aggregated Evidence* at 226.
[37] S&P Global Market Intelligence, *Major ESG investment funds outperforming S&P 500 during COVID-19*, April 13, 2020,
https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/major-esg-investment-funds-outperforming-s-p-500-during-covid-19-57965103.
[38] Brendan Coffey, Forbes, *ESG Stocks Are Beating The S&P By 45% This Year*, November 12, 2019, https://www.forbes.com/sites/brendancoffey/2019/11/12/esg-stocks-are-having-a-fantastic-year/#6a8281182fbb.
[39] Hugh Leask, Hedgeweek, *New BlackRock research points to ESG resilience during coronavirus downturn*, May 15, 2020,
https://www.hedgeweek.com/2020/05/19/285741/new-blackrock-research-points-esg-resilience-during-coronavirus-downturn.
[40] US SIF, *Sustainable Investing Basics*, https://www.ussif.org/sribasics (accessed July 6, 2020).
[41] https://www.unpri.org/pri/about-the-pri; https://www.unpri.org/annual-report-2019/2018/19-in-numbers.

from portfolio companies, and 50% report they are "very likely" to sponsor or co-sponsor a shareholder proposal related to sustainability issues.[42] A July 2020 Government Accountability Office (GAO) report noted how important ESG disclosure is to U.S institutional investors: "Most institutional investors GAO interviewed (12 of 14) said they seek information on environmental, social, and governance (ESG) issues to better understand risks that could affect company financial performance over time. These investors added that they use ESG disclosures to monitor companies' management of ESG risks, inform their vote at shareholder meetings, or make stock purchasing decisions."[43]

CalPERS, the largest U.S. public pension fund, researches how ESG topics may affect their investments; integrates ESG considerations into investment decision-making; and engages with companies and managers to understand, mitigate, and/or manage ESG risks and opportunities.[44] BlackRock, the world's largest asset manager, has stated, "Environmental, social, and governance issues are integral to our investment stewardship activities, as the majority of our clients are saving for long-term goals. . . . Our risk analysis extends across all sectors and geographies, helping us identify companies lagging behind peers on ESG issues."[45]

The New York City Comptroller and three retirement systems have asked companies that have issued statements on racial equality, diversity or inclusion to disclose specific diversity information, to allow investors to evaluate companies' abilities "to hire, retain, and promote employees of color and women." The investors noted that research suggests "that companies in the top quartile for gender and ethnic/cultural diversity on executive teams have stronger financial performance."[46]

Additionally, BlackRock has noted that capital is already being allocated towards reducing sustainability risks, and that this trend is accelerating. The firm argued, "markets are a long way from fully pricing in the far-reaching consequences of changing attitudes toward sustainability:

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[42] PwC. (2014). *Sustainability goes mainstream: Insights into investor views*. https://www.pwc.com/us/en/pwc-investor-resource-institute/publications/assets/pwc-sustainability-goes-mainstream-investor-views.pdf.

[43] GAO, *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them* (July 2020) at Highlights, 9-11,(https://www.gao.gov/products/gao-20-530.

[44] CalPERS, About the Sustainable Investments Program (https://www.calpers.ca.gov/page/investments/sustainable-investments-program/about-the-program), accessed July 5, 2020.

[45] BlackRock, Exploring ESG: A Practitioner's Perspective (June 2016) at 2, https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf.

[46] New York City Comptroller press release, *Comptroller Stringer and Three New York City Retirement Systems Call on 67 S&P 100 Companies Who Issued Supportive Statements on Racial Equality to Publicly Disclose the Composition of their Workforce by Race, Ethnicity and Gender* (July 1, 2020), https://comptroller.nyc.gov/newsroom/comptroller-stringer-and-three-new-york-city-retirement-systems-call-on-67-sp-100-companies-who-issued-supportive-statements-on-racial-equality-to-publicly-disclose-the-composition-of-their-workforce/.

the impact will be more pronounced on some assets than others, and some assets will likely disappear altogether as sustainable preferences are embedded into market pricing."[47]

Regarding examples of how investors consider ESG in engagement and investment decisions, consider water. Ceres has worked with investors to develop tools for them to better understand water risks, and factor these risks into their investment decisions. I encourage the Department to examine Ceres' Investor Water Hub case studies to understand better how investors are studying and addressing ESG risks, and consider how the proposed rule would hinder that work.[48]

The financial effects of ESG issues could manifest in the short, medium and long term

A recent MSCI research report demonstrates how different ESG issues affect financial performance over short, medium and long term time horizons. The firm analyzed an average of 1,600 companies, constituents of the MSCI World Index, over the time period of 2006 to 2019.[49] It analyzed three economic transmission channels from ESG characteristics to financial risk and performance—cash-flow, idiosyncratic risk, and valuation—using MSCI's ESG ratings.[50]

Specifically, MSCI's paper used its ESG pillar scores and their underlying Key Issues scores, which underpin the firm's ESG Ratings.[51] It found that different ESG indicators affected financial variables over different time horizons,[52] providing powerful evidence that appropriate investment horizons should incorporate ESG considerations over short, medium and long term time periods:

> "Governance pillar scores proved to be far more significant than Environmental and Social pillars over a relatively short period (one year) in terms of their impact on profitability, idiosyncratic risk and systematic risk, as they were most directly linked to short-term events and incident risks.
>
> "By contrast, Environmental and Social indicators were more significant over longer periods, as reflected in stock-price performance over the study period (2006-2019).

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[47] Black Rock Investment Institute, *Sustainability: The tectonic shift transforming investing – A framework for incorporating sustainable investing in portfolio construction* (February 2020) at 3, https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/sustainability-in-portfolio-construction.

[48] Case studies include, for example, Lessons from Breckinridge Capital Advisors: Methods for Integrating Water Risk into Corporate and Municipal Bond Analysis; Scientifically Assessing the Water Performance of Investments with PGGM: A Pension Fund's Mission to Quantify Sustainability and Positive Water Impacts; Lessons for Investors from a Drought Stress-Testing Tool: Methods and Data Insights From a Drought Stress-Testing Tool; and Water Risk Footprinting of a Passive Portfolio with Florida SBA: Insights and Benefits of Water Footprinting And the Methods Applied; available at Ceres, *Investor Water Toolkit*, Case Studies, https://www.ceres.org/resources/toolkits/investor-water-toolkit/details#case-studies.

[49] MSCI, Guido Giese, Zoltan Nagy, Linda-Eling Lee, *Deconstructing ESG Ratings Performance: Risk and Return for E, S and G by Time Horizon, Sector and Weighting* (June 2020) at 9, https://www.msci.com/esg/deconstructing-esg-performance.

[50] *Deconstructing ESG Ratings Performance* at 7, 9.

[51] *Deconstructing ESG Ratings Performance* at 5.

[52] *Deconstructing ESG Ratings Performance* at 42.

> "For example, carbon emissions and labor management showed no or minimal significance on profitability, idiosyncratic risk and systematic risk in the short term. However, it demonstrated the largest long-term performance impact of all 11 ESG Key Issues."[53]

<u>Investors have an affirmative duty to consider ESG factors that are material to investment performance in investment decisions</u>

Given that the materiality of ESG impacts and risks has now been extensively documented, and because such ESG-informed investments, on average, provide comparable or superior returns to non-ESG investments, investors have an affirmative duty to consider relevant, pecuniary-based ESG factors, especially where they could be material, in investment decisions.

The United Nations' Environment Programme and Principles for Responsible Investment conducted a global four-year study that addressed the question, "Is fiduciary duty a legitimate barrier to ESG integration by investors?" Their 2019 report produced extensive evidence showing the importance of incorporating ESG standards into regulatory concepts of fiduciary duty.[54] The report affirmed that most markets around the world have seen progress in incorporating ESG issues into expectations around investors' fiduciary duty – including in Canada, China, the EU, and the UK – with the notable exception of the U.S. markets.[55]

The report concludes that the fiduciary duties of loyalty and prudence require the incorporation of ESG issues into the investment process in the U.S. and other common law jurisdictions.[56] That includes requirements to incorporate ESG issues into investment analysis and decision-making, consistent with investors' investment time horizons; encourage high standards of ESG performance in the companies or other entities in which they invest; understand and incorporate beneficiaries' and savers' sustainability-related preferences; and report on how they have implemented these commitments.

The report argues there are three main reasons for this: that ESG incorporation is an investment norm, ESG issues are financially material, and policy and regulatory frameworks are changing to require ESG incorporation. Regarding those frameworks, the report notes that globally, there are over 730 hard and soft-law policy revisions, across some 500 policy instruments, that support, encourage or require investors to consider long-term value drivers, including ESG issues.[57] As many of our Investor Network members are invested in companies around the globe, they are already analyzing ESG risks that are disclosed under those policies.

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[53] *Deconstructing ESG Ratings Performance* at 3.
[54] Elliot, Rebecca, Elodie Feller, Will Martindale, Margarita Pirovska, Rory Sullivan, *Fiduciary Duty in the 21st Century: Final Report*, UNEP FI, PRI (October 22, 2019), https://www.unepfi.org/publications/investment-publications/fiduciary-duty-in-the-21st-century-final-report/.
[55] *Addressing Climate as a Systemic Risk* at 30.
[56] *Fiduciary Duty in the 21st Century: Final Report* at 8, 11, 21. The common law jurisdictions covered by the report are Australia, Canada, South Africa, the UK (in respect to England and Wales) and the U.S. *Id.* at 11.
[57] *Fiduciary Duty in the 21st Century: Final Report* at 8, 10-20.

Mercer has compiled evidence that considering climate risks is aligned with fiduciary duty, noting that "financial regulators are increasingly formalizing the expectation that investors should consider the materiality of these risks and manage them accordingly as part of their fiduciary duties — particularly for pension funds."[58] A Mercer report argues that two elements support this fiduciary duty alignment: the financial materiality of transition and physical damages risks and opportunities, and the growing legal and regulatory consensus that material climate-related factors must be considered and managed by fiduciaries.[59] Mercer noted that the expected financial materiality of these risks is supported by reports from the Bank of England, the Financial Stability Board, and The Economist Intelligence Unit.[60]

Many institutional investors have adopted this view. In 2019, State Street Global Advisors (SSGA) surveyed senior executives with asset allocation responsibilities at over 300 institutions, including private and public pension funds, endowments, foundations and government institutions (sovereign wealth funds).[61] Globally, 46% percent of respondents viewed ESG as part of their fiduciary duty.[62] In North America, a higher percentage, 59%, viewed it as part of their fiduciary duty, naming it as the leading factor for their decisions to integrate ESG considerations into their work. Responses suggested that two responsibilities to beneficiaries drove this view: mitigating ESG investment risks and shaping a sustainable economy.[63]

A 2019 statement by the International Organization of Securities Commissions (IOSCO) included the following recommendation for securities regulators: "Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, are encouraged to incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest."

Friede, Busch, and Bassen, in their metastudy *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, drew this main conclusion from their research: "the orientation toward long term responsible investing should be important for all kinds of rational investors in order to fulfill their fiduciary duties and may better align investors' interests with the broader objectives of society. This requires a detailed and profound understanding of

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[58] *Investing in a Time of Climate Change: The Sequel 2019* at 16.
[59] *Investing in a Time of Climate Change: The Sequel 2019* at 16-17.
[60] *Investing in a Time of Climate Change: The Sequel 2019* at 16, citing Bank of England. *The Bank of England's Response to Climate Change*, Quarterly Bulletin (2017 Q2), https://www.bankofengland.co.uk/quarterly-bulletin/2017/q2/the-banks-response-to-climate-change; Financial Stability Board, *Climate-Related Financial Disclosures*, https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/climate-related-financial-disclosures/; Economist Intelligence Unit, *The Cost of Inaction: Recognizing the Value at Risk From Climate Change* (2015), https://eiuperspectives.economist.com/sites/default/files/The%20cost%20of%20inaction_0.pdf.
[61] State Street Global Advisors, *Into the Mainstream: ESG at the Tipping Point* (November 2019) at 2, https://www.ssga.com/library-content/pdfs/insights/into-the-mainstream.pdf.
[62] *Into the Mainstream: ESG at the Tipping Point* at 8.
[63] *Into the Mainstream: ESG at the Tipping Point* at 8.

how to integrate ESG criteria into investment processes in order to harvest the full potential of value-enhancing ESG factors."[64]

The studies and trends noted above underscore that prudent investment practice requires investors to consider the impacts of ESG factors as a part of prudent investment practice. Under ERISA's duty of prudence, for example, the fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." § 404(a)(1)(B) of ERISA. This entails the courts "focus[ing] not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction." *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). A court's eye is "on a review of the fiduciary's independent investigation of the merits of a particular investment, rather than on an evaluation of the merits alone." *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983). Courts will look to the "totality of the circumstances" when evaluating whether a fiduciary acted prudently, including whether the fiduciary considered material investment risks. *See, e.g., DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007); *and Bunch v. W.R. Grace & Co.*, 555 F.3d 1, *7 (1st. Cir. 2009). Because it would be contrary to law for the Department to encourage fiduciaries to turn a blind eye to *material* investment risks and opportunities, whether ESG-related or not, I ask the Department to more clearly state that, when ESG issues present material risks or opportunities (*i.e.*, pecuniary-based), ERISA's fiduciary duties compel qualified investment professionals to consider them.

Therefore, we request that the Department more clearly state, in the final regulation (should the Department move forward with this proposed rule), that when ESG issues present *material* risks or opportunities (*i.e.*, they are pecuniary), ERISA's fiduciary duties would compel qualified investment professionals to consider them.

(3) The Department should retain the tie-breaker test, which allows for ESG factors to be considered for non-pecuniary reasons.

As the Department has recognized, ERISA's fiduciary duties "do not prevent plan fiduciaries from investing plan assets in [ESG] investments if the investment has an expected rate of return commensurate to rates of return of available alternative investments with similar risk characteristics, and if the investment vehicle is otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan." 85 Fed. Reg. 39113, 39114. This is known as the tie-breaker test and it has been utilized by the Department (and relied upon by fiduciaries and market participants) over many years in the context of ESG and economically targeted investments. *See, e.g.*, DOL Adv. Op. 98-04A and DOL Adv. Op. 85-36A (Oct. 23, 1985).

The tie-breaker test has clear echoes of both ERISA and the common law of trusts. The fiduciary may consider, as part of its proper evaluation of a prospective investment under ERISA, common law and the tie-breaker test, myriad factors (*e.g.*, expected return, degree of risk, cost, liquidity and whether the investment is appropriate for the plan based on the plan's liquidity and other

[64] *ESG and Financial Performance: Aggregated Evidence* at 227.

needs).[65] ERISA, trust law and the tie-breaker test were not designed to be straightjackets in how fiduciaries make investment decisions[66] or otherwise dictate to investment professionals which types of investments are *per se* prudent or imprudent.[67] Rather, substantive prudence duties are inherently flexible. Investments in blue chips *can* yield to investments in start-ups.[68] Investment strategies not yet the norm *may still* be prudent under ERISA, trust law and the tie-breaker test.[69]

Moreover, the fiduciary must always engage in a careful, deliberative process. A non-existent or haphazard decision-making process may taint the decision itself. Conversely, a fiduciary that carefully considers the relevant criteria, and meaningfully deliberates the proposed investment decision, demonstrates procedural prudence.[70] And so, fiduciaries cannot make decisions in the abstract but must undertake a process that reflects methods customarily used by other fiduciaries, such as pulling the requisite data and relying upon experts (as appropriate) in making an informed investment decision.[71] A methodical process that accounts for the aforementioned substantive factors is the heart of the duty of prudence.

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[65] *See* 29 CFR § 2550.404a-1(b)(i) and Restatement (Third) of Trusts § 90, comment (k).

[66] *See, e.g.*, Restatement (Third) of Trusts § 90, comment (e)(1) ("The usual emphasis on long-term investing, however, does not prevent the use of active management strategies. Nor does it necessarily preclude a trust investment strategy that makes competent use of investments or techniques that are often characterized as risky or "speculative." Such investments (for example, real estate and venture capital) or techniques (for example, borrowing and options or futures transactions) are not prohibited as long as they are employed in a manner that is prudently designed to reduce the overall risk of the trust portfolio or to allow the trust, in appropriate circumstances, to achieve a higher return expectation without a disproportionate increase in the overall level of portfolio risk.").

[67] *See, e.g.*, *Leigh v. Engle*, 858 F.2d 361, 367-68 (7th Cir. 1988) ("When investment advisors make decisions, they do not view individual investments in isolation. Rather, the goal is to create a diversified portfolio that balances appropriate levels of risk and return for the investor. The risk of a given investment is neutralized somewhat when the investment is combined with others in a diversified portfolio. The risk inherent in the entire portfolio is less than that of certain assets within that portfolio. Ideally, after diversification only market risk remains. Likewise, the return from a portfolio over time should be more stable than that of isolated investments within that portfolio. …Given the facts that investment advisors generally follow a portfolio strategy of investment and that beneficiaries whose assets are being managed are concerned with the end result of that strategy, not with the return on a single element in the portfolio, it makes sense for courts to look at the whole portfolio to determine the investment strategy's success.").

[68] *See, e.g.,* Preamble to the Final ERISA Prudence Regulation, 44 Fed. Reg. 37221.

[69] Restatement (Third) of Trusts, § 90, comment (e)(1) ("although it is ordinarily helpful in justifying the reasonableness of a trustee's conduct to show that an investment or strategy is widely used by trustees in comparable trust situations, the absence of such use does not render imprudent the informed, careful use of unconventional assets or techniques.").

[70] *See, e.g.*, *Donovan v. Walton*, 609 F.Supp. 1221 (S.D. Fla. 1985) ("ERISA 404(A)(1)(B) requires only that the Trustees vigorously and independently investigate the wisdom of a contemplated investment; it matters not that the investment succeeds or fails, as long as the investigation is "intensive and scrupulous and…discharged with the greatest degree of care that could be expected under all the circumstances by reasonable beneficiaries and participants of the plan." (*quoting Leigh v. Engle*, 727 F.2d 113, 124 (7th Cir. 1984)). *See also Katsaros v. Cody,* 568 F.Supp. 360 (E.D.N.Y. 1983); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418, 420 (4th Cir. 2007); *and* Restatement (Third) of Trusts § 90, comment (d).

[71] *See, e.g.*, *GIW Indus. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 895 F.2d 729 (11th Cir. 1990). *See also Howard v. Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996) (noting that while "securing an independent assessment from a financial advisor or legal counsel is evidence of a thorough investigation," a fiduciary should nevertheless investigate such expert's qualifications, provide the expert with complete and accurate information and ensure that reliance on the advice is reasonably justified).

I believe the Department should retain the tie-breaker test, which applies when the fiduciary considers an ESG investment for non-pecuniary reasons. As described above, the test is an extension of the existing prudence requirements under ERISA and the common law of trusts.[72] The Department should continue to have confidence in these protective principles and requirements, which have guided fiduciaries since ERISA's inception.

I worry, however, that statements in the proposed rule's preamble may suggest that the tie-breaker test is now no longer[73]a test remotely achievable. For example, the Department implies that the test fails unless the ESG investment and a non-ESG investment have the exact *same* performance history, fee structure, benchmark, investment strategy, and asset composition. 85 Fed. Reg. at 39117. Such interpretation would alter the tie-breaker test to no longer requiring a *comparison* but a *replication*, and it would mark a clear departure from ERISA and the common law of trusts, as described above. This construction would have the effect of wresting away the investment professional's ability to consider and weigh the myriad factors (as highlighted above) that differentiate one investment opportunity from another and instead impose an overly simplistic and overly strict check-the-box exercise that leads to only one result. I do not think ERISA supports such an approach.[74]

The Department should retain the tie-breaker test under duty of loyalty considerations, as well. Where an ESG investment is being pursued for non-pecuniary reasons, the tie-breaker test already identifies and addresses a potential duty of loyalty issue.The tie-breaker test is essentially a restatement of the incidental benefit doctrine for ESG-related investments. As the Department is no doubt aware, the incidental benefit doctrine provides that a fiduciary's investment decision that is in the best interest of participants and beneficiaries, but which happens to incidentally benefit the fiduciary, is *not* a violation of ERISA's duty of loyalty. The incidental benefit doctrine reflects the reality that small, collateral, incidental benefits may indeed flow to a fiduciary or others from everyday plan investment decisions, while *still* being protective of participants' and beneficiaries' retirement security. This has been recognized by many courts. *See, e.g.*, *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); *Morse v. Stanley*, 732 F.2d 1139, 1145, 1146 (2d Cir. 1984) ("It is no violation of a trustee's fiduciary duties to take a course of action which reasonably best promotes the interest of plan participants simply because it incidentally also benefits the corporation."). *See also Hugler v. Byrnes*, 247 F. Supp. 3d 223, 230 (N.D.N.Y. 2017) ("any benefit to the plan's fiduciary must be incidental to a decision that is otherwise independently in the best interests of the plan participants" (*citing In re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig.*, 842 F. Supp. 2d 614, 649 (S.D.N.Y. 2012)); *and Dupree v. The Prudential Ins. Co. of America*, 2007 BL 261609, 51 (S.D. Fla. 2007) ("[w]here, however, a

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[72] *See Chamber of Commerce of U.S. v. DOL*, No. 17-10238, 2018 BL 352943, *19 (5th Cir. 2018) ("The Supreme Court has warned that "there may be a question about whether [an agency's] departure from the common law…with respect to particular questions and in a particular statutory context[] renders its interpretation unreasonable" *citing NLRB v. Town & Country Elec., Inc.*, 516 U.S. 85, 94 (1995)).

[73] *See, e.g., Id.* ("DOL's turnaround from its previous regulation that upheld the common law understanding of fiduciary relationships alone gives us reason to withhold approval or at least deference for the [regulation].").

[74] *See, e.g., Chamber of Commerce of U.S. v. DOL*, No. 17-10238, 2018 BL 352943, *17 (5th Cir. 2018) ("A perceived "need" does not empower DOL to craft *de facto* statutory amendments or to act beyond its expressly defined authority.").

fiduciary takes action that arguably benefits both plan and non-plan interests, courts have held that some incidental benefit to other interests is permissible under the statute as long as the primary purpose and effect of the action is to benefit the plan."). The Department itself has also recognized that incidental, collateral benefits do not necessarily constitute impermissible conflicts of interest and self-dealing. DOL Adv. Op. 2000-10A (July 27, 2000).

The tie-breaker test and incidental benefits doctrine provide fiduciaries necessary breathing room while simultaneously protecting the interests of plan participants and beneficiaries in their retirement security. Whether the collateral and incidental benefit is ESG-related or not should make no difference. I respectfully request that the Department continue to offer the tie-breaker test.

By extension, and for the foregoing reasons, the Department should offer the tie-breaker test to fiduciaries who are selecting investment options for inclusion in defined contribution plan lineups. By requiring that a fiduciary "use[] only objective risk-return criteria" when selecting and monitoring investment alternatives, section (c)(3)(i)) of the proposed rule arguably prevents a fiduciary from even utilizing the tie-breaker test for these fiduciary decisions. The tie-breaker test was designed *precisely* for investment decisions not based entirely on pecuniary or objective bases. If a fiduciary may *only* use objective criteria based on risk-return criteria, as the proposed rule expressly requires, there is seemingly no room and no chance for the fiduciary to base its decision on collateral and incidental benefits, *even if* the tie-breaker test were to be met. A disparate approach to how fiduciaries treat non-pecuniary ESG investments based on the nature of the plan is inappropriate and creates needless confusion.

Indeed, the Department has long recognized the importance of harmonization when it comes to non-pecuniary ESG investment decisions and the broad applicability of the tie-breaker test. *See* DOL Adv. Op. 98-04A; *see also* FAB 2018-01 *and* IB 2015-01. I, therefore, urge the Department to state that an ERISA fiduciary may rely upon the tie-breaker test when selecting and monitoring, for non-pecuniary reasons, designated investment alternatives and other plan investment options.

(4) The Department should rely upon its existing, protective framework in whether a ESG fund (pecuniary or non-pecuniary) may constitute a QDIA or component of a QDIA.

I call on the Department to reexamine its position on ESG in the context of "qualified default investment alternatives," within the meaning of 29 C.F.R. § 2550.404c-5 (QDIAs). The proposed rule provides that, "the environmental, social, corporate governance, or similarly oriented investment mandate alternative [may not be] added as, or as a component of, a [QDIA]." ((c)(3)(iii)). I certainly appreciate the special character, and importance, of QDIAs for many participants and beneficiaries in their retirement security. But there is already a well-understood protective framework in place with respect to both the selection and monitoring of QDIAs.

Consider first that the selection and monitoring of a QDIA, whether ESG-related or not, "is a fiduciary act and, therefore, ERISA obligates fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries." 72 Fed. Reg. 60451, 60453 (Preamble)

(Dec. 24, 2007). *See also Tibble v. Edison Int'l*, 575 U.S. 523 (2015). ERISA's fiduciary duties, including when applied to selecting investment options for a 401(k) plan lineup, are exacting and are "the highest known to the law." *Bierwirth*, 680 F.2d at n.8. ERISA's duty of loyalty, for example, requires the fiduciary to act "with an eye single to the interests of the participants and beneficiaries." *Id. at* 271. ERISA's duty of prudence, moreover, focuses the attention on both the merits of the transaction, as well as the thoroughness of that decision-making process. *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). As noted above, courts will ultimately look to the "totality of the circumstances" when evaluating fiduciary conduct. *DiFelice*, 497 F.3d at 418.

If a fiduciary selects an ESG-related QDIA for *pecuniary* reasons, the analysis should begin and end with longstanding interpretations of ERISA's fiduciary duties, as well as the QDIA regulation, 29 C.F.R. § 2250.404c-5 specifically with respect to the fiduciary protection conferred under that safe harbor. A fiduciary that wishes to select an ESG-related QDIA for *non-pecuniary* reasons (*i.e.*, in whole or part for collateral benefits) already remains bound to the QDIA regulation (again, for purposes of availing itself of the protection under that safe harbor), ERISA's fiduciary duties, *as well as* the traditional tie-breaker test. As discussed earlier, the tie-breaker was developed precisely to address how non-pecuniary investments (including the selection of investment options in plan lineups) can be pursued in a manner consistent with ERISA's fiduciary duties. Like the incidental benefit doctrine, the traditional tie-breaker test is an extra shield used to allow some breathing room for fiduciaries while protecting the interests of participants' and beneficiaries' in their retirement income, as required under ERISA. The Department should resist the temptation to reinvent the wheel by discarding this long-standing practice.

I also note the point made by the Department in the preamble to the proposed rule that, "in the QDIA context a fiduciary's decision to favor a particular environmental, social, corporate governance, or similarly oriented investment preference—and especially a decision to favor the fiduciary's own personal policy preferences—would raise questions about the fiduciary's compliance with ERISA's duty of loyalty." 85 Fed. Reg. at 39119. But consider that duty of loyalty concerns arising in the ESG context are a principal reason why the traditional tie-breaker test was developed in the first place. I know this because the Department's own authority has *broadly* applied the tie-breaker test to ERISA's fiduciary duties under §§ 403 and 404 of ERISA. *See, e.g.*, IB 2015-01 *and* DOL Adv. Op. 98-04A. If there is a duty of loyalty concern, such as where a fiduciary is selecting an investment option or making some other fiduciary decision that confers some benefit to itself,[75] then the existing framework of the traditional tie-breaker test is *already* in place to protect the interests of the plan participants and beneficiaries.

In conclusion, the proposed rule is unnecessary, ill advised, inconsistent with the correct interpretation of fiduciary duty under ERISA, and inconsistent with widespread current investment practice. I therefore urge the Department to withdraw, or substantially modify it, in accordance with the above facts, evidence and considerations. I have also appended three attachments containing the complete source materials cited in the footnotes.

Finally, I respectfully request that the Department extend the comment period from 30 to 120 days. The Department first issued guidance on this topic over 25 years ago, and it is a matter of utmost concern to institutional investors. The importance of ESG issues to investors, companies and the U.S. economy has been extensively researched. Extending the comment period will provide investors and other stakeholders enough time to provide meaningful substantive feedback on the proposal.

I would like to provide my appreciation to Jim Coburn, Senior Manager, Disclosure for drafting this letter. If you have questions or thoughts, please contact us at coburn@ceres.org.

Sincerely,

Mindy S. Lubber
CEO and President
Ceres, Inc.

cc: Honorable Eugene Scalia, Secretary of Labor

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[75] I agree with the Department that ERISA requires fiduciaries to act for the exclusive purpose of providing benefits to participants. If I consider Congress' purpose for enacting ERISA, and the statute's text, the term *benefits* "must be understood to refer to the sort of financial benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's beneficiaries." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 420-21 (2014). Policy or political preferences of participants, which are likely to be numerous and competing, are not the type of benefits Congress sought to protect under ERISA. *See, e.g.,* DOL Adv. Op. 2008-05A (June 27, 2008) ("The ERISA statute, and all subsequent guidance issued by the Department, makes it clear that in deciding whether and to what extent to make, or refrain from making, a particular investment, a fiduciary may only consider factors relating to the interests of plan participants and beneficiaries in their retirement income."); *and* DOL Adv. Op. 2007-07A (Dec. 21, 2007) ("The Department has previously expressed strong concern about the use of plan assets to promote particular legislative, regulatory or public policy positions that have no connection to the payment of benefits or plan administrative expenses."). I further add that the duty of loyalty requires the fiduciary to "deal even-handedly among [participants and beneficiaries], doing his best for the entire trust looked at as a whole." *Morse v. Stanley*, 732 F.2d 1139, 1145 (2d Cir. 1984). *See also Varity Corp.*, 516 U.S. at 514 ("The common law of trusts….requires a trustee to take impartial account of the interests of all beneficiaries."); *Talarico v. United Furniture Workers Pension Fund*, 479 F. Supp. 1072, 1081 (D. Neb. 1979) ("…the Trustees of the Fund must exercise their discretion to serve the interests of all the participants in the Fund."); *and Winpisinger v. Aurora Corp. of Illinois, 456 F. Supp. 559, 566 (N.D. Ohio 1978)*("In addition to reinforcing the prohibition against self-dealing provided by [§ 1104](A), the lead line of [§1104](a)(1) is construed to require that in the discharge of his duties with respect to a plan (referring to the administration of a plan rather than to its establishment) the fiduciary is forbidden from granting preference as between a plan's participants or as between a plan's beneficiaries.").