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Via Electronic Submission

Mr. Joe Canary, Director
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 by the Employee Benefits Security Administration, U.S. Department of Labor

Dear Mr. Canary:

Pursuant to the Request for Comments published by the U.S. Department of Labor ("DOL") in the Federal Register, 85 Fed. Reg. 39113 (June 30, 2020), The Wagner Law Group is pleased to submit this letter setting forth concerns regarding the proposed regulatory language and its potential effect on fiduciary consideration and selection of investments and investment alternatives for employee benefit plans, including fiduciary consideration of environmental, social, and corporate governance factors ("ESG Factors").

A universal principle underlying ERISA fiduciary duties is that benefit plan investments must always be made in the best financial interests of a plan and its participants. The DOL has proposed amending its regulation at 29 C.F.R. §2550.404a-1 titled "Investment Duties" to both modify longstanding guidance on fiduciary duties of loyalty and prudence in selecting investments solely in the interests of a plan, and to implement specific rules for fiduciary consideration of ESG Factors in making investment decisions.

Investing, however, is both a science and an art with a myriad of possibilities heavily dependent on relevant circumstances. By formally articulating that investment decisions are to be made only considering "pecuniary factors" the DOL shines a spotlight on how difficult it is to define the concept of a "pecuniary factor" in the abstract. Amending this regulation as proposed would arguably set stricter standards for investment decision making than current law provides and would make it more difficult for fiduciaries and their counsel to understand how the DOL expects fiduciaries to fulfill their duties as they evaluate different investment options.

The proposed amended regulation could also be interpreted to set forth inconsistent standards for different types of benefit plans. Immediately after stating that fiduciaries can only consider ESG Factors in evaluating and selecting investment options under strict, heightened circumstances, the proposal contradicts itself and states that fiduciaries can evaluate and select ESG investment alternatives for self-directed individual account plans if they use certain objective criteria. ERISA fiduciary duties, however, are the same for all employee benefit plans. Creating different fiduciary standards based on benefit plan characteristics seems inconsistent with ERISA and would be a surprising and unwelcome departure from the DOL's typical approach to providing broad advice guiding fiduciary conduct.

ERISA Fiduciary Duties of Prudence and Loyalty

ERISA mandates that fiduciaries to employee benefit plans invest plan assets both with the care and skill of a prudent person and solely in the interests of participants and beneficiaries for the exclusive purpose of providing plan benefits. These principles necessarily require that fiduciaries make each investment decision based on the anticipated financial value to their plans, and that fiduciaries cannot subordinate plan interests, accept unnecessary risk, or sacrifice investment return to promote unrelated objectives or interests, as described in existing sub-regulatory guidance and in the proposed amended regulation.[1]

The proposed amended regulation also states that fiduciaries should evaluate investments "based solely on pecuniary factors that have a material effect on the return and risk of an investment based on appropriate investment horizons and the plan's articulated funding and investment objectives." As explained below, we are concerned that the proposed amended regulation uses the definition of "pecuniary factors" to restrict fiduciary exercise of investment discretion more than current law and guidance allows, which would make fiduciary investment decision making more difficult than it already is.

ESG Investment Vehicles and DOL Guidance

As explained in the Preamble, the impetus for amending the Investment Duties regulation is the emergence of ESG investment funds. The proposed regulation uses the term "ESG Factors" but, as noted in the Preamble, the concept has had different names over time, such as socially responsible investing or economically targeted investing. ESG investment funds consider corporate policies relating to environmental, social and corporate governance issues in

[1] Proposed new subsections (b)(1)(iii) and (iv) state that a fiduciary must not subordinate plan interests to unrelated objectives or another's interests, or sacrifice investment return, or take on additional investment risk to promote goals unrelated to the financial interests of a plan. This letter does not comment on these portions of the proposed regulation.

making investment decisions, recognizing that investing in a company or sector provides financial support, and ties financial success, to such articulated policies.

The DOL explains that it is aware of increased emphasis in the marketplace on investments that promote ESG Factors. The DOL expressed concern that the growing emphasis on considering ESG Factors in investing could prompt ERISA plan fiduciaries to make investment decisions for reasons "distinct from" providing benefits to plan participants and beneficiaries. The DOL is also concerned that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance. Recognizing that DOL has issued "varied statements" in sub-regulatory guidance over the years on how fiduciaries may navigate consideration of ESG Factors, the DOL proposes this amended regulation to, it asserts, eliminate confusion and "provide clarity and certainty regarding the scope of fiduciary duties surrounding non-pecuniary issues."

Solely Upon Pecuniary Factors

The proposed regulation, however, clouds rather that clarifies; it sows confusion by imposing new standards that constrict fiduciary decision making without explanation, making it harder, not easier, for fiduciaries to comply with their obligations, and increasing their litigation and compliance risk.

The fiduciary duty of loyalty has long been understood to include that investment decisions must be made solely in the interests of participants and beneficiaries to further a plan's financial needs and goals. The fiduciary duty of prudence has long been interpreted to require fiduciaries to carefully consider investment characteristics and alternatives under relevant facts and circumstances. The DOL's proposed amended regulation goes beyond formalizing this longstanding guidance, however, to state, at proposed subsection (b)(1)(ii), that a fiduciary will satisfy duties by evaluating "investments and investment factors *based solely upon pecuniary factors that have a material effect on the return and risk of an investment based upon appropriate investment horizons and the plan's articulated funding and investment objectives*" (emphasis added).

While this language purports to articulate existing guidance, the DOL's description of "pecuniary factors", repeated as a new definition in proposed subsection (f)(3), adds a new standard using undefined terms that could have a significant effect on how fiduciaries exercise discretion in evaluating investment options.

The duty of loyalty to act "solely" in the interests of a plan's participants and beneficiaries has been generally understood to mean that a fiduciary must put plan financial interests first and paramount in evaluating the relevant facts under prevailing circumstances, not

that a fiduciary must only consider financial interests. The proposed regulation, however, adopts the narrower approach; if a fiduciary will satisfy duties by evaluating investment options "based solely upon pecuniary factors" the proposed regulation necessarily excludes from consideration any factor that does not meet the definition of "pecuniary."

A fiduciary does not, however, under current law and guidance, automatically breach fiduciary duties simply by considering relevant factors outside the proposed definition. For example, if this regulation is implemented as proposed will it still be permissible for a fiduciary to decide between similar investment options based on interviews of investment manager finalists recommended by an investment consultant? How will a fiduciary choose between index funds with the same investment objectives and similar characteristics managed by different financial institutions? Can fiduciaries consider business reputation in choosing among options? How about a company's sponsorship of fundraising efforts for cancer research? Could a firm's reputation for good customer service be used as a factor in deciding? How about a reputation for poor customer service? While each of these factors would not meet the "pecuniary" definition proposed each could be a relevant factor that fiduciaries might take into consideration in exercising fiduciary duties in choosing among investment options.

The proposed definition of "pecuniary" also uses undefined terms such as "material effect" and "appropriate investment horizons" with limited guidance on how to apply them, creating further uncertainty as to how the DOL anticipates that fiduciaries will comply.

The proposed amended regulation would be impractical in application and would set a new, narrower, standard for fiduciary decision making that would unnecessarily limit factors for fiduciaries to consider in exercising their fiduciary responsibility. We urge the DOL to reconsider the proposed standard limiting fiduciary consideration to "pecuniary factors."

Available Alternative Investments

Other sections in the proposed regulation also raise questions regarding how fiduciaries would apply them in practice. Proposed new subsection (b)(2)(ii)(D) states that a fiduciary is to consider how an investment compares to "available alternative investments" in evaluating how the investment will further a plan's objectives, considering its portfolio with respect to diversification, liquidity, current return, anticipated cash flow requirements, and the projected return of the portfolio relative to the funding objectives of the plan.

While it is an accepted best practice for fiduciaries to compare alternative investments, this proposed regulation suggests that it would be necessary to go beyond comparing options to each other and also consider how each alternative would fit in a plan's portfolio. What constitutes an "available" alternative further raises questions on how this provision is to be

applied. Are fiduciaries expected to consider different types of investment vehicles with similar objectives, such as comparing mutual funds and collective trusts? How many alternatives would fiduciaries be expected to compare? Implementing this regulation as proposed would inject uncertainty and could result in fiduciaries expending time and resources engaging in additional layers of analysis that are not required under current law and guidance and would not necessarily improve either the process or the results.

Specific Standards for Consideration of ESG Factors

While the proposed changes to subsection (b) do not mention ESG Factors, the proposed new subsection (c)(1) specifically sets stricter standards for consideration of ESG or other similarly oriented considerations. Repeating that a fiduciary must evaluate an investment option based only on pecuniary factors, the proposed regulation states that ESG and similarly oriented considerations *"are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories"* (emphasis added). The weight given to those factors should appropriately reflect a prudent assessment of their impact on risk and return, and fiduciaries considering ESG Factors as pecuniary would be required to examine diversification, liquidity, and risk-return in comparison with available alternative investments that would play a similar role in a plan's portfolio.

The proposed regulation isolates ESG Factors – a term that the DOL recognizes is not uniformly understood or defined – founded on an implied assumption that ESG Factors are inherently not pecuniary, without factual explanation. Under the proposal ESG Factors may only be treated as pecuniary if "qualified" investment professionals applying "generally accepted investment theories" – also undefined and unexplained terms – would treat them as having material economic impact. The regulatory language as proposed is vague and ambiguous with respect to both when and how it is intended to apply; the proposed regulation would make it harder, not easier, for fiduciaries to exercise their responsibilities in evaluating described investment opportunities.

Moreover, the proposed ESG standard is the only guidance offered on how a fiduciary could consider a non pecuniary factor in evaluating investment options, further underscoring that the proposed regulation would limit fiduciaries to considering only defined "pecuniary factors" in making all investment choices.[2]

[2] While the subsection is titled "Consideration of Pecuniary vs. Non-Pecuniary Factors" it only explains how ESG Factors can be treated as pecuniary factors.

The ESG limitation also helps to illustrate the ambiguity in the proposed regulation by requiring fiduciaries to compare ESG investments against non-ESG alternatives. With no other guidance on what fiduciaries would be expected to do to compare alternatives, or why they would be expected to do so and what value would be gained, the proposed regulation creates additional uncertainty for fiduciaries in selecting any investments, with or without consideration of ESG Factors.

Economically Indistinguishable Alternative Investments

The proposed regulation also includes a new subsection (c)(2) on "economically indistinguishable alternative investments," which, if one was not drafting proposed regulations in the Federal Register, would be referred to as "all things being equal" or tie-breaker rules. Prior DOL guidance had advised that where investments were of comparable financial value it was permissible to consider ESG Factors in deciding between them, essentially a tie-breaker rule. The new DOL guidance severely limits application of this rule to alternative investments that are "economically indistinguishable", positing that finding such indistinguishable alternatives will be very rare after consideration of described "pecuniary" factors. A fiduciary faced with such unexpected choice who selects an investment *based on a non-pecuniary factor or ESG factors* must document specifically why the investments were determined to be indistinguishable and why the selected investment was chosen based upon the purposes of the plan, diversification of investments, and the interest of plan participants and beneficiaries in receiving benefits from the plan.

If implemented as proposed this regulation will make it difficult if not impossible for fiduciaries to consider any factor that is not cast as "pecuniary" in investment decisions and essentially repeals the tie-breaker rule espoused in earlier DOL guidance. This provision applies to decision making based on any "non-pecuniary" factor, not just ESG Factors, further indicating that the proposed regulation anticipates that decision making will be limited to consideration of defined "pecuniary" factors.

This subsection also states that a fiduciary making such an investment decision has a substantive duty to document the reasoning supporting it. While it is certainly consistent with fiduciary best practices to keep records demonstrating fiduciary decision making, this provision also raises enforcement concerns. What happens if a fiduciary prudently makes a described investment decision, but the DOL does not think that adequate records were maintained? Would such be considered a violation of the duty of prudence under this regulatory guidance? What would be the remedy? The recordkeeping requirement is only triggered where a fiduciary makes an investment decision under circumstances that the DOL suggests will rarely happen, so, if implemented, the provision is unlikely to be tested. It is curious, then, that this recordkeeping

provision was even included in the proposed regulation, seemingly adding unnecessary complexity.

Selecting Investment Alternatives for Individual Account Plans

Finally, in subsection (c)(3) the proposal addresses fiduciary selection of investment alternatives for individual account plans. The proposed regulation first repeats that the standards in amended subsections (b)(1) and (b)(2) apply, which include the new standard limiting fiduciary considerations to defined "pecuniary factors."

The proposal then sets forth a different standard for self directed individual account plans, stating that a fiduciary may add one or more "prudently selected, well managed, and properly diversified investment alternatives" that include one or more ESG or similarly oriented "assessments or judgments in their investment mandates," or include these parameters in a fund name, if (i) the fiduciary uses only "objective risk-return criteria, such as benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, and mix of asset types (e.g., equity, fixed income, money market funds, diversification of investment alternatives, which might include target date funds, value and growth styles, indexed and actively managed funds, balanced and equity segment funds, non-U.S. equity and fixed income funds)" in the selection and monitoring of all investment alternatives for the plan including any ESG or similarly oriented investment alternatives; (ii) the fiduciary documents its selection and monitoring of investments in accordance with these criteria, and (iii) the ESG or similarly oriented investment alternative is not added as, or as a component of, the plan's qualified default investment alternative ("QDIA").

Proposed subsection (c)(3) sets standards for fiduciary consideration of ESG investment options, but specifically limits the guidance to selections for self-directed individual account plans. As noted in the definitions section of the regulation, the term "plan" means "an employee benefit plan to which Title I of the Act applies." The DOL has not offered legal support or justification for setting different standards for investment decision making for different types of plans. If a fiduciary selecting an ESG focused investment for a self-directed individual account plan can evaluate and make a prudent decision considering described risk-return criteria in the selection and monitoring of all investment alternatives, including ESG or similarly oriented investment alternatives, why would a fiduciary making investment decisions for a different type of plan not be able to exercise fiduciary judgment by considering the same factors?

The DOL also does not explain how this provision is to be understood in connection with the rest of the proposed regulation. Doesn't this provision describe pecuniary factors to consider in evaluating all types of investments, including investments using ESG Factors? Doesn't this

standard undercut the assumption in subsection (c)(1) that ESG Factors are inherently non-pecuniary?

The provision is also internally inconsistent, as it incorporates the standard limiting fiduciary consideration to defined "pecuniary factors" in proposed subsection (b)(1)(ii) and in the next sentence proposes a different standard for fiduciary consideration of investment alternatives for self directed individual account plans, focusing instead only on described "objective risk-return criteria."

Missed Opportunities

The proposed regulation also skirts relevant issues discussed in the Preamble that may make it difficult for both fiduciaries and investment professionals to consider described factors in evaluating ESG investment options. As the DOL noted, the investment market has not yet developed uniform definitions for ESG Factors in investing, which leads to difficulty in establishing appropriate benchmarks and identifying alternatives with similar objectives. Considering ESG Factors adds a layer of analysis, but it is not a separate investment class; ESG investment vehicles may use very different objectives while adopting similar ESG considerations. For example, investment funds that consider fossil fuel dependence could invest in large established companies with funded research and development goals or in startup companies exploring alternative fuels. While the DOL noted that the SEC is working on guidance related to offered securities with ESG components, the proposed regulation seems to steer fiduciaries away from ESG investments instead of offering guidance on how to evaluate investment vehicles that use ESG Factors in their missions.

Conclusion

The proposed rule amending the DOL's longstanding regulation on Investment Duties should not be implemented as published. As explained above, the proposed amended regulation is inconsistent with existing law and guidance because it would require fiduciaries to only consider defined pecuniary factors in selecting investments, instead of using their judgment and discretion to evaluate investments under the totality of circumstances. The DOL cannot specify all potentially relevant considerations, and a narrow listing of permissible factors is inconsistent with the notion that prudence is not determined by a checklist and is a fact specific determination.

The regulation as proposed also includes provisions that are incompatible with each other, setting different fiduciary standards for selection of investment alternatives for self directed individual account plans, even though the same ERISA fiduciary duties apply to all types of plans.

The proposed standards for consideration of ESG Factors are similarly inconsistent, describing in proposed subsection (c)(3) factors for fiduciaries of self-directed individual account plans to consider in evaluating investment options, including options with ESG components, after declaring in subsection (c)(1) that fiduciaries can only consider ESG Factors under a heightened standard, with no support or explanation for the disparate treatment.

We thus urge the DOL to retract and reconsider the proposed regulation. If the DOL still believes that rulemaking is necessary the DOL should consider holding hearings and collecting relevant evidence to better inform the DOL as to the impact that this proposed rule could have on investment decision making.

Thank you for your consideration.

Sincerely,

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