OFFICE OF THE ILLINOIS STATE TREASURER
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July 30, 2020

VIA ELECTRONIC FILING

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

RE: Proposed Rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

Dear Director Canary,

I write to voice my strong opposition to the proposed rulemaking entitled "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) ("Proposed Rule"). The Employee Benefits Security Administration ("EBSA") under the Department of Labor ("Department") announced the Proposed Rule on June 23, 2020, to provide interpretive guidance to the U.S. Employee Retirement Income Security Act of 1974 ("ERISA"). I also request an extension of the comment period from 30 days to 120 days for public comments on the notice of the Proposed Rule.

As the Treasurer of the State of Illinois, I am responsible for safeguarding and prudently investing $32 billion on behalf of the people of the State of Illinois, taxpayers, retirement and college savers, and units of local government (collectively referred to as "Beneficiaries"). Through the integration of sustainable or environmental, social and governance ("ESG") factors to measure the sustainability and societal impact of an investment, my office can more effectively execute its fiduciary duties and serve the interests of Beneficiaries. These activities are critical in our endeavor to provide the highest level of service, stewardship, and financial value to our Beneficiaries and participants.

Analyzing the material impacts of ESG issues provides a more complete view of an investment, its past performance, and future potential. Consideration of ESG factors is beneficial to determining the best investments by looking at factors that ultimately result in stronger returns and better companies and funds to invest. The integration and consideration of ESG factors has proven valuable to our Beneficiaries.

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The Proposed Rule is concerning for several reasons. **First, the Proposed Rule assumes ESG considerations are not widely applied, and fails to recognize a history of effective use of material ESG considerations by mainstream institutional investors.** The Proposed Rule reveals a fundamental misunderstanding of how professional investment managers use ESG criteria as an additional level of due diligence and analysis in the portfolio construction process. Investment managers analyze ESG factors precisely because they view these factors as material to financial performance. Research demonstrates that 73% of global investors take ESG issues into account in their investment analysis and decision-making.[1] A July 2020 Government Accountability Office ("GAO") report notes that the majority of institutional investors agreed that ESG issues have a large impact on a company's long-term performance and they actively sought this information to better understand risks to their investments.[2] The use of sustainability factors has been shown to minimize risk and maximize returns and is considered a best practice in the investment industry.

Furthermore, the Proposed Rule also assumes that ESG factors are not material. The Sustainability Accounting Standards Board ("SASB") analyzed the materiality of ESG factors on company performance and developed a framework to consider ESG risks in 77 industries. SASB standards have undergone extensive vetting by industry experts, comprising a balanced group of corporate professionals, investors, and other stakeholders. **They identified ESG risks as material factors in many industries and demonstrated that investors have a viable interest to consider these risks across their portfolios.**

I have reviewed the letter dated June 30, 2020, submitted to the Department on the proposed rule by Ceres, a thought leader on these issues, *and I fully support their recommendations*. I am concerned that the Proposed Rule would dissuade fiduciaries from assessing ESG risks and opportunities in their investments.

I strongly urge the Department to withdraw the Proposed Rule. The Proposed Rule, if enacted, would restrict my ability to consider factors that may result in increased returns for Beneficiaries and participants. Specifically, I call on the Department to acknowledge that ESG issues may in fact pose material short-, medium-, and long-term financial impacts and risks. **Fiduciaries are well-positioned to consider ESG factors and their impact on their investment portfolios. The consideration of ESG factors is used to comprehensively analyze an investment based on its entire risk profile and return potential.**

The Proposed Rule assumes that ESG strategies sacrifice financial returns, but a substantial body of evidence demonstrates that consideration of ESG factors in the investment decision-making process allows for better review of the investment in determining management and mitigation of risks and helps determine long-term value.[3] ESG factors can pose short, medium-, and long-term financial

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[1] CFA Institute, *CFA Institute Survey: How Do ESG Issues Factor into Investment Decisions?* (August 2015) at (https://blogs.cfainstitute.org/marketintegrity/2015/08/17/cfa-institute-survey-how-do-esg-issues-factor-into-investment-decisions/)

[2] 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).

[3] *See e.g.,* Morningstar, *U.S. ESG Funds Outperformed Conventional Funds in 2019* (April 2020) at (https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019); Morgan Stanley, *Sustainable Reality; Analyzing Risk and Returns of Sustainable Funds* (2019) at (https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-investing-offers-

impacts and risks to companies and financial markets. Consideration of these factors does not sacrifice returns; it enhances them.

Various ESG factors pose systemic risks to financial markets. Typical large-scale issues such as population growth, resource constraints, urbanization, technological innovation, violations of law, and climate change can and do have profound effects on business outcomes and should be considered in order to deliver favorable returns.

Our main urging is to withdraw the proposal given it is unnecessary and counter to the interests of investors and beneficiaries. However, in the absence of this action, I ask that you make the following changes to the Proposed Rule:

1. **Clarify that when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to consider them.** As noted above, U.S. investors are already considering ESG in investment decision-making. Analyzing the material impacts of ESG issues provide a more complete view of an investment, it's past performance, and future potential. Thus, it is vital that plan fiduciaries consider these material impacts and risks. Furthermore, ESG investments, on average, provide comparable or superior returns to non-ESG investments. It would be a violation of fiduciary duty to not consider sustainability factors in investment decisions.

2. **Retain the existing interpretation of the tie-breaker test, which allows for ESG factors to be considered for non-pecuniary reasons.** The proposed rule in effect redefines the "tie-breaker" test (*i.e.*, the "all things being equal test") that a fiduciary would have to meet when it is making an investment decision on behalf of an ERISA plan for *non-pecuniary* reasons (*i.e.*, "collateral benefits"). The traditional and long-standing tie-breaker test is a much more workable standard. The traditional 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. The Department should also reinstate the traditional tie-breaker test for fiduciaries who are selecting investment options for inclusion in defined contribution plan lineups.

3. **Rely upon the Department's existing, protective framework in whether an ESG fund (pecuniary or non-pecuniary) may constitute a Qualified Default Investment Returns ("QDIA") or component of a QDIA.** QDIAs possess a special character and importance 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. 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."

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.

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financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf); Harvard Business Review, *The Comprehensive Business Case for Sustainability* (October 2016) at https://hbr.org/2016/10/the-comprehensive-business-case-for-sustainability.

A fiduciary who 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.

To reiterate, **I respectfully request that the Department of Labor withdraw the Proposed Rule.**

Additionally, I respectfully request that the Department extend the comment period from 30 days to 120 days to provide stakeholders with the time necessary to fully analyze and provide additional comments on this proposed rulemaking. A 30-day comment period is particularly challenging considering the continuing impact of COVID-19 on business continuity and workplaces. Further, given the substantive impact of the proposed rule, other market participants should be afforded the opportunity to thoroughly review and comment on this fundamental and critical investment process.

Thank you for your time and attention, and please do not hesitate to contact me with any questions.

Sincerely,

Michael W. Frerichs
Illinois State Treasurer