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Submitted Electronically
Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor

Re: **Financial Factors in Selecting Plan Investments Proposed Regulation**

Dear Sir or Madam:

I am writing on behalf of Capital Group to comment on the Department of Labor's proposed regulation on the consideration of environmental, social and governance (ESG) factors in plan investments.

Capital Group[1] does not offer ESG funds for use in plan investments. However, the consideration of ESG factors is an integral part of our long-term investment philosophy. We believe ESG factors have an impact on investment results and are important considerations to effectively manage risk and achieve our clients' investment objectives. The consideration of ESG factors is a core part of our investment process and intrinsic to our fundamental research. We assess ESG factors – alongside financial and other business indicators – as important inputs in our investment decision-making process. We believe our investment philosophy, which integrates the consideration of ESG items as pecuniary factors into all investment decisions, aligns well with the basic premise of the Department's proposed regulation. We agree that ESG factors can "present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."

We are, however, concerned that the regulation is overbroad in certain respects. The proposed regulation would impose new requirements on individual account plans that offer investment options that include "one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates."[2] The consequences of

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[1] Capital Group is one of the oldest and largest asset managers in the nation. Through our investment subsidiaries, we manage approximately $2 trillion in assets in separate accounts and various collective investment vehicles. Most of the assets we manage are in the American Funds family of mutual funds.

[2] We understand this language to refer solely to non-pecuniary assessments or judgments that take into account economic, social, governance and other similar considerations. We suggest, however, that Department clarify this

offering a fund that falls within this definition would be twofold. First, plans could not utilize a target date series as a qualified default investment alternative if that series includes a component investment with non-pecuniary environmental, social or corporate governance judgements in its investment mandate and, second, plans that choose to offer as a stand-alone investment option a fund that falls within this definition would need to document that the fund was offered solely for pecuniary reasons.

This broad definition will sweep in many funds that are not considered ESG funds. For example, we manage two mutual funds that prohibit investments in issuers that derive the majority of their revenues from alcohol or tobacco products. The funds do not reflect these restrictions in their names, the restrictions are not part of the funds' investment objectives or strategy and the funds are not marketed as ESG funds.

Alcohol and tobacco restrictions of this type have a long history in investment funds and are qualitatively different than the types of restrictions that have been embraced by the emerging universe of ESG funds. Our funds adopted the restrictions in 1959 and 1962, respectively. While the origins of our decision to include alcohol and tobacco restrictions in these funds is somewhat murky given that more than 50 years have elapsed, there is evidence that the restrictions were added at the behest of church and church-affiliated pension plans that were interested in avoiding a potential misalignment with Christian values. While the motivation arose from church plan sponsors, the concern was more fundamentally with the possibility of discouraging participation if the only investment options available to participants with strong religious convictions permitted investments in companies that derived a majority of their revenues from alcohol and tobacco products. Today these restrictions may fairly be viewed by participants and plan fiduciaries as reflecting a judgment about the likely long-term destruction of value if an issuer derives the majority of their revenues from alcohol and tobacco products, which have faced and continue to face obvious regulatory and societal headwinds.

These restrictions are also different than prevailing ESG restrictions because they are incidental or de minimus in nature. Alcohol and tobacco stocks currently represent less than 1% of the S&P 500 Index, which is the primary benchmark for both of the funds at issue. Given the modest nature of the restrictions, our funds do not, and are not required to, reflect these restrictions in their investment objectives or principal investment strategies, although they are disclosed in the funds' statement of additional information. Importantly, unlike ESG funds, we are not choosing to affirmatively invest in certain stocks for non-pecuniary reasons. We are simply screening out alcohol and tobacco stocks. We appreciate of course that the Department is

point in the final regulation. It would be wholly inappropriate if the requirements and prohibitions in the regulation applied solely because the fund manager considers ESG factors as they relate to the investment merits of an issuer.

not in the business of "picking winners and losers." Our point is simply that funds with alcohol and tobacco prohibitions are not the types of funds that raise ESG concerns.

Our funds are far from the only funds with these restrictions. Restrictions on alcohol and tobacco investments are sufficiently common among mutual funds that Morningstar maintains a database of funds with such restrictions. These funds are widely held by defined contribution plans and we include our funds with alcohol and tobacco restrictions as component investments in our target date series, which is broadly utilized as a qualified default investment alternative.

We are especially concerned about the per se prohibition on the use of these funds as component investments in a qualified default investment alternative. The prohibition would force us to either modify the long-standing investment restrictions for these funds or remove the funds from our target date series. Both options would be disruptive and result in investment decisions based on regulatory considerations, not the investment merits. We do not believe changes of this magnitude are warranted by the funds' long-standing and narrow investment restrictions and we urge the Department to modify the proposed regulation to accommodate funds of this type.

We believe a better approach would be to apply the new requirements to investment funds that reflect ESG considerations in the fund's name, objective or principal investment strategy. Each of these concepts is easily applied objectively. A plan fiduciary can simply look at the fund's prospectus to determine whether a fund is subject to the regulation's additional documentation requirement or prohibition on use as a qualified default investment alternative or a component investment in such an alternative. Moreover, there is a mature body of law under the Investment Company Act of 1940, as amended, that regulates each of these concepts. Under Form N-1A, for example, to the extent certain ESG considerations form a material part of a fund's investment objective or strategy, they would need to be reflected accordingly in the fund's prospectus.

We appreciate that the proposed rule would apply to investment funds other than regulated investment companies such as CITs and separate accounts. However, these vehicles invariably adhere to similar rules and maintain a characteristics document that is comparable to a prospectus. Significantly, the Department has in prior regulations relied on Form N-1A rules for mutual funds and other investment vehicles.[3]

The approach we recommend would have a number of virtues. First, it would screen out funds that have incidental or de minimus investment restrictions since these restrictions would not be disclosed as part of the fund's objective or principal investment strategy. Second, as a practical matter, it would capture all funds that are marketed as ESG funds. Form N-1A would limit an issuer's ability to simply sidestep the Department's requirements by omitting ESG factors from

[3] See 2550.404a-5 (preamble to proposed and final regulations relying on Form N-1A for important disclosures, including performance data, expense ratios, turnover rates and benchmarks).

the name, investment objective and investment strategy while still pursuing ESG factors for non-pecuniary reasons. Finally, it would avoid disruption to long-standing investment policies and mitigate concerns about restrictions that are based in religious beliefs.

We also note that the approach we suggest would avoid a potential trap for the unwary. In our experience, plans offering our funds with alcohol and tobacco restrictions as stand-alone investment options do so solely based on pecuniary factors, including the funds' modest investment fees and successful long-term investment results. A requirement that fiduciaries document that the funds were selected based solely on pecuniary factors would be a significant trap for the unwary plan fiduciary. Because these funds are generally not viewed as ESG funds in the marketplace, many fiduciaries will not make the connection to the new regulation's requirements.

While we strongly believe that more appropriately tailoring the scope of the regulation is the right way to address the issues at hand, we would be remiss if we did not mention an alternative approach to qualified default investment alternatives. We understand that the Department's view is that a default investment fund should not be used to "push" the environmental, social or governance goals of the plan's fiduciaries either directly or through underlying component investments. However, we believe this policy goal can be accomplished in a more targeted manner.

Our target date series is managed by a committee of investment professionals who select the funds that are included, and their relative weighting, based solely on pecuniary factors. Individually each of the funds at issue represents less than 10% of a vintage's portfolio, neither fund is marketed or classified as an ESG fund and the target date series itself is not marketed or classified as an ESG fund. In this context, it cannot be fairly said that the component investments in a default investment alternative are being used to impose the plan fiduciary's values on participants.

A simple approach to the appropriate treatment of component investments in a qualified default investment alternative is to allow component ESG investments where the investment professionals responsible for managing the qualified default investment alternative select the component investments solely based on pecuniary factors. The proposed regulation contemplates that a plan fiduciary may select an ESG fund solely for pecuniary reasons and we believe that an investment manager to a qualified default investment alternative should similarly be free to select an ESG component investment solely for pecuniary reasons. A manager of a fund of funds that takes into account non-pecuniary factors in the selection of underlying investment components would be obligated to disclose that in the fund's prospectus, whether as a risk of investing in the fund or otherwise, and plans should be able to rely on the absence of such a disclosure to determine that a target date fund, for example, is not selecting components based on non-pecuniary factors.

For the reasons discussed above, we recommend targeting application of the regulation's new requirements and restrictions to funds that use ESG factors in their name, investment objective or principal investment strategy. However, if the Department is not willing to narrow the scope of the rule, the Department should at a minimum permit a qualified default investment alternative to include an investment component that falls within the scope of the regulation if that investment was selected by the manager of the default investment alternative based solely on pecuniary considerations.

We appreciate your consideration and would be happy to answer any questions. Please call the undersigned if we can be helpful at 213-615-4007.

Sincerely,

Jason Bortz
Senior Counsel