July 30, 2020

Office of Regulations & Interpretations
Employee Benefit 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 Regulation

Ladies and Gentlemen:

We welcome the opportunity to comment on the proposed rule "Financial Factors in Selecting Plan Investments." PAi provides administrative retirement services for participant directed save at work programs such as 401(k) plans. We work in concert with familiar financial brands such as banks and broker-dealers as well as technology based service providers and presently provide retirement solutions for over 16,000 employers throughout the United States.

In a review of the proposed regulation regarding Financial Factors in Selecting Plan Investments, we have several operational observations that we believe warrant your consideration prior to the issuance of a final regulation, as noted below:

1. **Impact on Recordkeeping Systems**
   The proposed rule will cause marketplace behaviors that recordkeepers will be expected to operationalize for our customers and partners. The rule improperly characterizes ESG investments as a binary function; like a light switch that is either on or off. In practice, all investments have an ESG profile that falls somewhere on a wide spectrum. Where an investment is on that spectrum is heavily dependent on the methodology used in evaluative tools. While there are some tools available to help fiduciaries determine the ESG characteristics of individual holdings, these tools may vary in their methodologies and outcomes and the tool selected may cause an investment to be an eligible QDIA on one recordkeeping platform, but not on another. The QDIA is, unlike ESG factors, binary, and recordkeepers will need to facilitate the addition of a "not eligible for QDIA – ESG" flag on systems to support plan fiduciaries. Neither would be wrong, based on their proprietary methodologies, but the lack of definition in what constitutes an ESG investment will cause confusion, not clarity, in the reporting of investment information to plans and, by extension, participants.

   We are unclear as to how a plan fiduciary can or should determine if a particular investment has an objective that includes non-pecuniary goals. This is particularly important where the ESG determination may disqualify an investment from being eligible for inclusion in a qualified default investment alternative, including managed accounts. As a recordkeeper, under the proposal, we will be expected to take the information available to us with regard to an investments ESG considerations and determine whether the investment would be disqualified from inclusion in a QDIA and require an enhanced level of due diligence to assist plan fiduciaries. We do not believe there is sufficient clarity around what constitutes a fund having an objective including non-pecuniary goals to enable such a data feed.

2. **Recognition of human behaviors and motivations**

We believe that the level of activism represented in an investment or a plan could, in some circumstances, lead to positive behaviors for plan participants. Individual employees are less likely to contribute to the plan if they know the plan investment alternatives subjugate their personal values. We encourage EBSA to reach out to Nest Corporation to learn about their experience incorporating ESG offerings into their National Employment Savings Trust pension scheme in the United Kingdom. In our highly volatile social environment, elevating the importance of quantitative, pecuniary factors above qualitative, non-pecuniary factors in creating the investment lineup could reasonably be expected to result in lower savings rates and, consequently, suboptimal retirement outcomes.

EBSA should consider that there is a significant number of participants in 401(k) plans who have to choose between participating in a plan and holding tight to their religious beliefs. If the proposed rule is implemented, plan fiduciaries would be prohibited from providing these employees with investments that allow them to participate in the plan without violating religious beliefs, effectively discriminating against participants on the basis of religion. We would anticipate the constitutionality of such actions may be challenged absent a carve out for these situations.

The Department of Labor has been a staunch supporter of expanding coverage of workplace savings vehicles; a goal we agree is of utmost importance in combatting the savings crisis that exists in the United States presently. There is a segment of the business community who would not care to offer a workplace savings vehicle to their employees but who are active in attempts to effect societal changes, and may be motivated to offer a plan if an option were available that aligns with their worldview. Policies that are detrimental to expanding coverage are also detrimental to the retirement outcomes of millions of U.S. workers who are employed by socially engaged employers. We feel that the proposed rule would serve as an impediment to expanding coverage.

3. **ESG considerations are not inherently imprudent**

We understand that the Department is concerned that a bifurcated focus in the selection of plan investments may violate the exclusive benefit rule. Where a fiduciary maintains a primary focus on the accomplishment of some societal outcome when it would clearly subvert the best interest of plan participants is problematic. ERISA already makes clear the scope of a fiduciary's responsibilities, as do similar rules regarding fiduciary duty of investment advisers. There are many studies that show there are economic benefits associated with ethical corporate behaviors. While I'm certain others have provided more robust analysis with regards to this matter, we encourage you to review "E.S.G Risk Factors in a Portfolio Context" (risklab, 2009), "The Link Between ESG and Performance" (Robeco, 2019). The Department's implied view that investing in funds that incorporate ESG factors will produce lower returns than those that do not consider ESG factors does not appear to be based in historical data nor is it aligned with the views of leading asset managers who have increasingly view ESG considerations as part of their investment strategy. We're being asked to facilitate the intersection of individuals qualified plan and the rest of their financial assets, which helps participants gain the holistic picture that they need to be successful. The proposal effectively restricts access to plan participants while investors outside a qualified plan enjoy the benefits of current investment theories. Qualified plan participants deserve the same investment opportunities as are available in the marketplace broadly.

4. **Unintended consequences and costs**

Every investment has some level of social activism. If a plan selects a sector fund to offer participants an opportunity to purchase investments in the energy sector, would that be an activist play against environmentalists? Does the inclusion of individual public corporations within a mutual fund that has prominent ESG corporate policies cause the fund to be treated as non-pecuniary? If a fund is labeled an ESG fund but it has an identical ESG score as the S&P 500 index, does a fiduciary have to treat it differently? If a participant has a self-directed brokerage account and invests in a corporation known for social activism, would a fiduciary have an obligation to facilitate the enhanced due diligence requirements on that individual stock holding under the proposal? It is difficult, if not impossible, to determine where to draw the line.

In a review of our own 401(k) plan, we found that three investment alternatives were deemed to be socially conscious, which was defined as a fund that "selectively invests based on certain non-economic principles. These investments have no stated goal to effect societal change. They were deemed socially conscious because ESG factors were referenced as contributors to an overall evaluative strategy used by the fund managers. After spending hours attempting to ascertain what social impact these funds serve, I was unable to draw a reasonable conclusion based on the data available. If an investment is deemed to be imprudent in all instances there are non-pecuniary factors in play, fiduciaries will screen for ESG considerations because they don't want to deal with the additional scrutiny, robbing participants of the opportunity to participate in what may be a more suitable option. In much the same way the fee disclosure rules prompted heavy adoption of passively managed options, this rule will cause a fire sale on investments that consider ESG factors, even where such consideration is not a primary driver of the underlying holdings and the replacement fund is viewed as inferior, simply to avoid the scrutiny in the litigious society we live in today.

The DOL's impact on participants under this proposed rule would attempt to optimize outcomes by protecting against bad practices and, consequently, avoiding sub optimized outcomes. Unfortunately, the current environment supports an environment not of "do the right thing" but instead "don't do the wrong thing." Even though the effect of index investing is not to "win", but instead to "not lose" the impact on growth in the overall economy is negative. Growth comes from competing to win – not from competing to "not lose". Qualified plans, particularly 401(k) plans, is where U.S. workers participate in the equity markets. As an industry we seek to expand the investment options available to produce growth for our participants. The increase in passive investments tells us that plan fiduciaries and participants have become content with being average. We believe the U.S. workers deserve extraordinary; they need the government to facilitate fiduciary actions that may lead to extraordinary outcomes by affording them the unfettered ability to manage their plan to meet the needs of their participants where they are. By restricting access to investments with ESG considerations, EBSA is putting U.S. workers at a disadvantage relative to other retirement systems globally.

The amount of time it will take a fiduciary to comply with this proposal is drastically understated in this proposal. At a minimum, a fiduciary for every plan, not just the ones that think they have an ESG fund, will need to undertake the task of determining if any of its investments are, directly or indirectly, undertaking ESG considerations. Further, I believe that the number of ESG investments in plans may be materially greater than estimated in the costs of this proposal, as evidenced by our own plan analysis. Once identified, the fiduciary will need to ensure there is documentation overtly supporting the selection with only pecuniary factors and/or engage in the process to find an alternative investment. For all plans that end up having no ESG funds, fiduciaries will have invested several hours researching this matter, with no benefit. According to the proposals estimates this is roughly 80% of all plans where costs are incurred for no benefit. The benefit on the other 20% is predicated on an assumption that the investments with ESG considerations will lag the performance of investments without ESG considerations, which is, at best, questionable.

The cost of making changes to recordkeeping systems, as noted above, is not contemplated at all in the proposal. Recordkeepers may be expected to subscribe to additional data feeds, enhance reports, add processes and create educational materials for our employees, customers and partners. While these are not exceptionally high costs, it does create pressure for the already low-margin recordkeeping services industry and may eventually increase costs to customers Overall, we believe this proposal grossly understates associated costs and makes a substantial assumption on any potential benefits.

We appreciate your willingness to consider our comments prior to issuing a final regulation on this matter. Further, if it would be helpful, we would welcome the opportunity to discuss these concerns in greater detail.

Sincerely,

Michael P. Kiley
President
PAi

Mark S. Nicholas
Chief Compliance Officer
PAi Trust Company, Inc.