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July 30, 2020 *Electronically Submitted*

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

Attention: Docket No. RIN 1210–AB95

Re: Arizona Public Service Company Comments on Notice of Proposed Rulemaking *Financial Factors in Selecting Plan Investments*

Dear Mr. DeWitt:

Arizona Public Service Company ("APS") appreciates the opportunity to submit comments on the Department of Labor's (hereinafter "the Department") Notice of Proposed Rulemaking, *Financial Factors in Selecting Plan Investments,* set forth at 85 Federal Register 39,113 (June 30, 2020) (hereinafter, the "Proposed Rule" which term also includes the "preamble" to Proposed Rule).

As one of the Southwest's largest electric utilities, APS understands and appreciates the tremendous value that transparency plays in fostering accountability which leads companies to ultimately be more adaptable and resilient. The Proposed Rule makes clear the Department's desire to instill integrity in the decision making process for these important financial judgments under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). As a company with a dedicated sustainability division committed to helping APS, its customers and community build a sustainable energy future, APS understands first-hand how risk-return ESG factors can be intricately tied to a company's long term performance and even be considered by investors.

Although APS firmly believes in the value of regulatory clarity and, in particular, the importance of ensuring that pension plan fiduciaries act with complete and undivided loyalty to the beneficiaries, we are unable to support this proposed rule for the reasons set forth below.

APS hopes that our comments assist the Department in addressing the noted deficiencies and establishing a solid foundation from which the Department can move forward.

The Department Does Not Provide An Adequate Reason for the Proposed Rule

It is important in a rulemaking process to fully explain the foundations and facts that justify the enactment of a federal regulation. In the preamble to the Proposed Rule, the Department asserts that there are "long-established principles of fiduciary standards for selecting and monitoring investments," and cites existing statutes, rules, and court opinions, along with multiple Interpretive Bulletins and a Field Assistance Bulletin. Unfortunately, the Department fails to provide data or examples to show that the cited statutory, regulatory, and sub-regulatory elements are somehow inadequate in managing the obligations of a fiduciary. Seeking to codify existing principles and standards without data showing a clear problem of violations, failures on the part of fiduciaries, or even notable consternation on the part of fiduciaries in interpreting or utilizing the existing principles and standards does not provide an adequate foundation for rulemaking.

The Department justifies the rulemaking by expressing concern "that the growing emphasis on ESG investing *may be* prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan."[1] (emphasis added) We encourage the Department to look for a more solid foundation to initiate a rulemaking than a concern that something "may be" happening.

In fact, the Department actually acknowledges that it does not have sufficient data regarding compliance with current law and guidance and essentially concludes that any non-compliance is small because most are operating in compliance with the Department's guidance.

> While the Department does not have sufficient data to estimate the number of such fiduciaries, the Department believes it is small, because most fiduciaries are operating in compliance with the Department's sub-regulatory guidance.[2]

Accordingly, by expressly acknowledging that most fiduciaries are operating in compliance, and without sufficient data establishing that the existing regulatory and guidance process is not working or that there are important gaps, it would be premature to assume that codification is the answer.

[1] 85 Fed. Reg. 39113, 39116
[2] 85 Fed. Reg. at 39120

The Rule Will Not Result In Substantial Benefits

Integral to any assessment of the "need" for a rule is an evaluation of the benefits and the costs. A rulemaking that does not result in substantial benefits or that imposes unreasonable costs would therefore fail to support a need. The conclusion drawn by the drafters of the Proposed Rule in Section 1.8 Conclusion, reads as follows: "Although the proposed rule would replace previous guidance, the Department believes that there is significant overlap; thus, this would not result in substantial benefits or costs."[3] The Department itself has concluded that the Proposed Rule would not provide substantial benefits, thereby obviating the need for a rulemaking.

Benefits Of The Proposed Rule Are Lacking

In analyzing the benefits from the Proposed Rule, the Department acknowledges that it is replacing existing guidance with this rule and, without data or objective inputs, concludes "the resulting benefits will be appreciable."[4] These two ideas conflict.[5] How can the Department conclude that resulting benefits will be appreciable, without providing any factual or objective support?

The Department reaches similarly disconnected conclusions in the next several paragraphs. The Department states, "[w]hen fiduciaries weigh nonpecuniary considerations as required by this rule to select investments, some fiduciaries will select investments that are different from those they would have selected pre-rule. These selected investments' returns will generally tend to be higher over the long run."[6] The Department also asserts that "the societal resources freed for other uses due to lessened active management (minus potential upfront transition costs) would represent benefits of the rule."[7]

Again, the Department is claiming a benefit of the Proposed Rule without providing a basis for its conclusion. Curiously, the assertions made earlier in the Proposed Rule actually work against such a conclusion. Earlier in the Proposed Rule, the Department states that "the Department does not have sufficient data … [and] most fiduciaries are operating in compliance with the Department's sub-regulatory guidance."[8] Consequently, without sufficient data, and with the recognition that most fiduciaries are in compliance, there can be no logical conclusion

[3] 85 Fed. Reg. at 39123
[4] 85 Fed. Reg. at 39121
[5] The assertions set forth in the Section D. Regulatory Impact Analysis "Benefits" analysis of the rule (section 1.3 Benefits) which asserts "the resulting benefits will be appreciable" also clearly conflicts with the overall conclusion in the preamble (section 1.8 Conclusion) "this would not result in substantial benefits or costs." This incongruency further exemplifies the concerns we have about the basis for the need for this rulemaking. 85 Fed. Reg. at 39121
[6] Id.
[7] Id.
[8] 85 Fed. Reg. at 39120

that the investment returns will be higher over the long run or that it will free up "societal resources."

As the Department notes on several occasions in the Proposed Rule, there is a current structure in place that has been working well for the pension fiduciaries,[9] so it is unclear why the Department feels the need to create more regulation. It is suggested that the Department either reassess this rulemaking or take the additional steps to do a more thorough benefits assessment.

Alternatives Are Lacking

The Department appears to misunderstand the purpose of examining "alternatives to the proposed regulation" and instead merely provides a list of more stringent requirements that were ultimately not chosen.

In Section 1.7 of the Proposed Rule, the Department sets forth its analysis of alternatives to the proposed regulation. In assessing the alternatives, the Department considered such things as: prohibiting plan fiduciaries from ever considering ESG or similar factors; prohibiting fiduciaries from utilizing the "all things being equal" test; and expressly incorporating an obligation to focus only on pecuniary factors, along with several other considerations. Ultimately, the Department determined that "the approach reflected in the proposal best reflects the statutory obligations of prudence and loyalty, appropriately ensures that fiduciaries' decisions will be guided by the financial interests of the plans and participants to whom they owe duties of prudence and loyalty, and is the easiest to apply and enforce."[10]

A true assessment of alternatives to a proposed regulation should focus less on what requirements could have been proposed, and more on actual "alternatives" to the Proposed Rule, including, for example, improved guidance or orders, enhanced enforcement, stakeholder engagement, and education.

Because of the "longstanding and consistent position, reiterated in multiple forms of sub-regulatory guidance,"[11] and the lack of confusion on the part of fiduciaries, "because most fiduciaries are operating in compliance with the Department's sub-regulatory guidance,"[12] a viable alternative might be for the Department to simply do outreach to determine if fiduciaries actually see this as a problem, after which the Department could determine if an updated Interpretive Bulletin, rather than a rule, is a better alternative.

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[9] As the Department has noted, because of the "longstanding and consistent position, reiterated in multiple forms of sub-regulatory guidance," (85 Fed. Reg. at 39114) there does not appear to be much, if any, confusion on the part of fiduciaries, "because most fiduciaries are operating in compliance with the Department's sub-regulatory guidance." (85 Fed. Reg. at 39120)

[10] 85 Fed. Reg. at 39123

[11] 85 Fed. Reg. at 39114

[12] 85 Fed. Reg. at 39120

The Proposed Rule Targets Environment, Social And Governance (ESG) But Fails To Define These Terms

Although the goal of this Proposed Rule is to help guide fiduciaries in their role, the Department focuses much of its efforts on the influence of ESG. For example, the Department states that the Proposed Rule is designed to prevent fiduciaries from investing in ESG vehicles under certain circumstances.[13] The Department also notes that it "has been asked periodically over the last 30 years to consider the application of these principles to pension plan investments selected because of the non-pecuniary benefits they may further, such as those relating to environmental, social, and corporate governance considerations."[14]

In fact, the Proposed Rule uses the term "ESG" dozens of times, and acknowledges the complexity and inter-related nature of the terminology by noting that "[v]arious terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social, and corporate governance (ESG) investing, impact investing, and economically targeted investing. The terms do not have a uniform meaning and the terminology is evolving."[15]

Ultimately, the Department concludes that "[t]here is no consensus about what constitutes a genuine ESG investment, and ESG rating systems are often vague and inconsistent, despite featuring prominently in marketing efforts."[16] Rather than clarify this essential part of the Proposed Rule, the Department fails to provide definitions for these terms. This will ultimately leave fiduciaries uncertain about the scope of the rulemaking.

Without a clear understanding of this terminology it is difficult to understand the scope of the Proposed Rule. If the purpose of the rule is, as the Stanford Law Review article cited by the Department points out, to establish a clear distinction between ESG utilized for risk-return assessment, which is permissible under ERISA, and ESG utilized for collateral benefits (e.g. ESG investing for moral or ethical reasons or to benefit a third party),[17] which is not permissible under ERISA, it would behoove the Department to take the time to define ESG and to distinguish between the permissible and impermissible uses thereof, which are the heart of this issue.

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[13] 85 Fed. Reg. at 39116 "This proposed regulation is designed in part to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of nonpecuniary objectives."

[14] 385 Fed. Reg. at 9114

[15] Id.

[16] 85 Fed. Reg. at 39115

[17] 85 Fed. Reg. at 39120 Footnote 35, Citing Schanzenbach & Sitkoff, *supra* note 5, at 389–90 (distinguishing between ''collateral benefits ESG'' investing—defined as ''ESG investing for moral or ethical reasons or to benefit a third party''—which is not permissible under ERISA, and ''risk-return ESG'' investing, which is).

The Proposed Rule Fails To Address The Unintended Consequences

The Proposed Rule fails to address the inverse or unintended consequences of this Proposed Rule's focus on ESG. For example, if pecuniary gain is the primary focus, would it not be possible for a company/fund that follows ESG principles to outperform a company/fund that does not follow ESG principles? Clearly, it is possible. However, a potential unintended consequence of the Proposed Rule could be that a fiduciary may see a simple solution to compliance with this Proposed Rule as not engaging with ESG funds or companies that promote ESG principles. The result, using the company performance example above, would be that the fiduciary might be unintentionally working *against* the pension plan's financial benefit just so the fiduciary can avoid the potential missteps and violations warned about in this Proposed Rule. In other words, by focusing on ESG, the Proposed Rule may cause a chilling effect where fiduciaries avoid ESG funds/companies in order to minimize potential missteps, only to find that they are actually forfeiting better financial performance.

Additionally, fiduciaries must act prudently and are required to diversify the plan's investments in order to minimize the risk of losses. The Proposed Rule could have the unintended consequence of making it difficult for fiduciaries to meet their primary responsibility to act prudently and to properly diversify the plan's investments, if they conclude their best option is to forego ESG investments rather than try to navigate the complexities of ESG analysis under this Proposed Rule.

If these examples of unintended consequences prove to be real, it will take the Department considerable time, upwards of 18 months for some rulemakings, to repeal or revise the rule. However, if the Department merely updated an Interpretive Bulletin, such unintended consequences could be resolved rather quickly. Accordingly, we suggest that the Department revisit the need for this Proposed Rule and preferably look towards sub-regulatory options and/or just greater education.

Compliance with Executive Order 13771

Finally, it is worth noting that Executive Order 13771 requires that "whenever an executive department or agency publicly proposes for notice and comment or otherwise promulgates a new regulation, it shall identify at least two existing regulations to be repealed."[18] It is unclear from the Proposed Rule which, if any, existing regulations are being repealed in order to provide compliance with Executive Order 13771.

[18] Executive Order 13771

Conclusion

APS appreciates the thought and effort the Department has put into addressing the importance of the fiduciary's duty under ERISA. We certainly encourage the Department to provide clarity on any ambiguities in the existing rules or bulletins. But given the defects in the proposed rules, as articulated in our comments, there is no legal basis to promulgate these rules and the Department should withdraw them. APS is concerned that, if enacted without the necessary foundation and factual support, this rule will have the unintended consequence of chilling investment in funds and companies that utilize ESG principles and risk-return based on transparency, accountability and resiliency—even if those companies/funds actually perform as well as or better than competitors.

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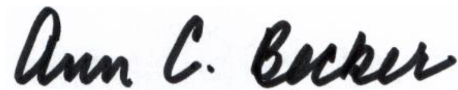
APS appreciates this opportunity to provide comments. If you have any questions or need more details, please contact us.

Sincerely,



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