Public Comments Overwhelmingly Oppose Proposed Rule Limiting the Use of ESG in ERISA Retirement Plans

Julie Gorte, Impax Asset Management, LLC
Jon Hale, Morningstar Research Services, LLC
Bryan McGannon, US SIF
Georges Dyer, Intentional Endowments Network
Billy Gridley, Ceres
Brandon Rees, AFL-CIO
Josh Zinner, Interfaith Center for Corporate Responsibility

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INTRODUCTION[1]

On June 30, 2020, the U.S. Department of Labor (DOL) Employee Benefits Security Administration issued a Notice of Proposed Rulemaking (NPRM) titled "Financial Factors in Selecting Plan Investments." The proposal amends the "Investment duties" regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), to confirm that ERISA requires plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action.

This innocuous sounding description conceals the real purpose of the NPRM, which is to limit the use of investments that consider environmental, social, and corporate governance (ESG) issues in worker retirement plans subject to ERISA. By singling out a group of funds whose track record and performance demonstrates competitive or superior risk-adjusted returns with little to no empirical evidence for doing so, the rule would likely penalize retirement plans, asset owners and managers with burdensome new requirements that are both unnecessary and unwarranted. It would also substitute the judgment of government bureaucrats for the wisdom of financial markets.

While agencies typically allow at least a 60-day period for interested parties to comment on an NPRM, in this case the DOL provided for only a 30-day comment period on a matter of significant and growing interest to investors and retirement-plan participants and beneficiaries. Despite this unusually short comment period, the NPRM drew 8,737 comments

[1] Principal authors of this Report are Julie Gorte, PhD, Impax Asset Management, LLC, and Jon Hale, PhD, CFA, Morningstar Research Services, LLC.

during the brief comment period, including several petition letters signed by thousands of individuals. *More than 95% of the comments opposed the rule.*

While the DOL is required to read and consider the arguments made in the comments before making a final determination, we are concerned that the short comment period it provided and the short time before the November election indicates an intention to rush through a final rule. Before that happens, we want to make sure that the public is well-informed about the comments that were made.

As investment professionals who believe that ESG factors are important considerations in investment decisions and whose organizations all submitted letters in opposition to the NPRM, we wanted to better understand who commented and the levels of support and opposition to the proposal expressed in the comments. While we were concerned about past instances of fake comments being submitted to the DOL and the SEC surrounding its proxy advice and shareholder-resolution rulemakings, our purpose was not to identify suspicious comments but simply to summarize the comments and who made them for the sake of transparency to help the public, affected parties and regulators draw appropriate conclusions from the thousands of comments submitted.

To that end, we have read each comment letter, characterized it as in favor of or opposed to the NPRM, and categorized its author by investor type.

DATA & METHODOLOGY

Our research proceeded in four steps:

1. We downloaded all 8,737 comments from the DOL website.

2. Next, we assigned each comment to one of 13 commenter types. We also placed each category into three overarching commenter groups: investment-related firms and organizations, non-investment-related firms and organizations and individuals.

   Investment-related firms and organizations included asset managers, financial advisors, financial service providers, not-for-profit advocacy and trade organizations, pension funds, and asset owners. Non-investment groups included policy advocacy groups, trade associations, academics, attorneys, public officials, and companies.

3. We characterized each comment as being in favor of or opposed to the NPRM, as well as those that took neutral or mixed positions. We removed extension requests and duplicates, leaving a total of 8,686 comments in our analysis.

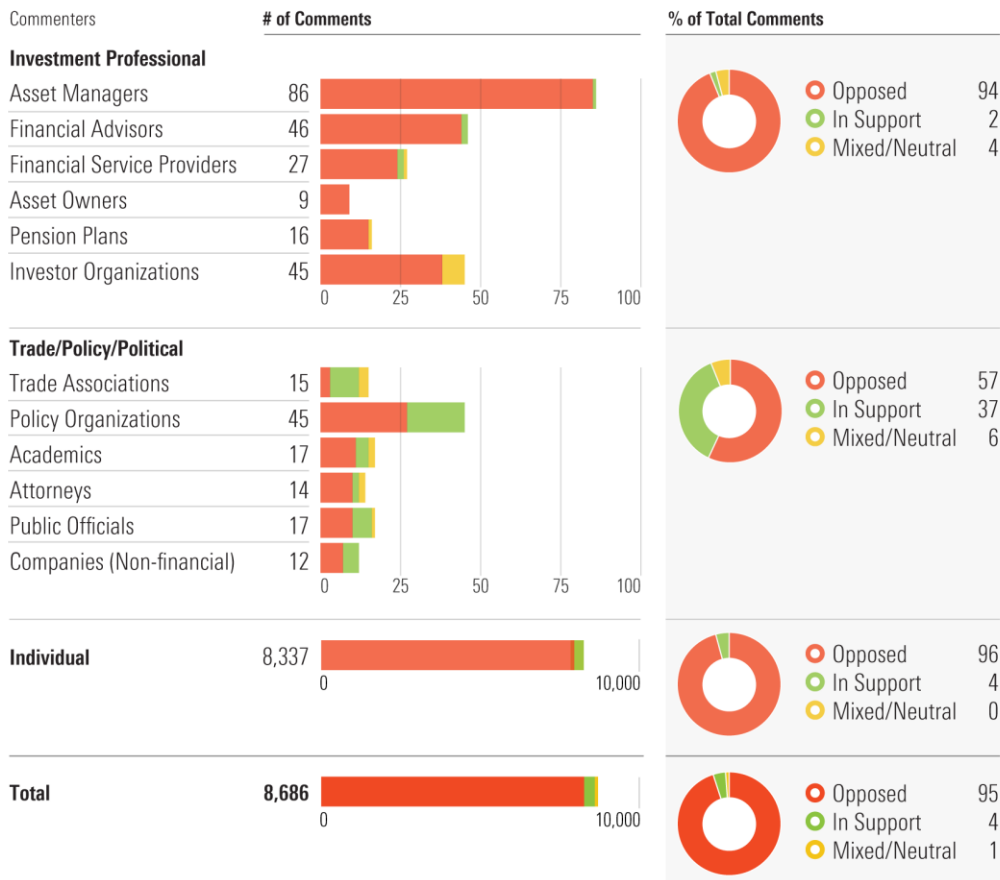
4. Finally, we noted key takeaways found in the opposing comments, which we highlight in the final section of the report.

FINDINGS

95% of Comments Oppose the Proposed Rule

We found the comments overall to be overwhelmingly opposed to the NPRM, with 95% of commenters expressing their opposition, only 4% expressing their support and 1% expressing neutral views or recommending changes without clearly expressing support or opposition.

Public Comments on U.S. Dept of Labor Proposed Rule, "Financial Factors in Selecting Plan Investments"



Public comments on U.S. Dept. of Labor Proposed Rule, "Financial Factors in Selecting Plan Investments," downloaded by authors from https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95.

- **Comments from Individuals: 96% Opposed**
  The vast majority of commenters were individuals, many of whom expressed their views in a single sentence or paragraph while others signed on to petition letters. Among individual commenters, 96% expressed opposition to the NPRM, a reflection of significant grass-roots investor support for sustainable investing. A petition letter from Green America attracted more than 7,000 signatures. Another petition letter sponsored by the American Sustainable Business Council and Social Venture Circle was submitted by more than 400 individuals.

- **Comments from Groups: 81% Opposed**
  Far fewer in number but typically more detailed were the comments received from various firms, organizations, and professionals with academic or legal credentials. These comments often contained detailed arguments and referenced evidence that the DOL must consider before finalizing the rule. Of comments received from the dozen groups overall, 81% were opposed to the NPRM, 14% supported it, and 5% expressed mixed or neutral views, usually along with suggested changes.

  - **Investment-Related Firms and Organizations: 94% Opposed.** Among professional investors, opposition to the NPRM was especially high. Of 229 comments in our analysis, 94% are opposed to the NPRM, only 2% are in favor, and 4% are mixed or neutral. *Not a single comment in support of the NPRM was received from investment-related organizations, pension plans, or asset owners.*

    Asset Managers are nearly unanimous in their opposition, with only one out of 86 comments in favor. Opposing comments came not only from asset managers focused on ESG investing but from many large conventional asset managers, including BlackRock, Fidelity, State Street Global Advisors, T. Rowe Price, and Vanguard. The single supportive comment came from a small ETF firm called Vident Financial. Financial service providers, such as Envestnet and Morningstar, oppose the rule 24 to 2, with 1 mixed/neutral comment.

    Similarly, financial advisors voiced strong opposition, with 44 of 46 commenters opposing the rule. It is also likely that many more financial advisors were among the more than 8,000 individuals who registered their opposition.

- **Non-Investment-related Firms and Organizations: 57% Opposed.** Non-investment groups, including policy advocacy groups and trade organizations, account for only 120 comments. While these groups exhibit the highest levels of support for the NPRM, with 37% of comments in favor, a clear majority of comments from these groups are opposed (57%) and 6% mixed/neutral.

  Trade and policy advocacy organizations that support the NPRM include the American Conservative Union, American Legislative Exchange Council, National Association of Manufacturers, National Taxpayers Union, National Shooting Sports Foundation, and the Western Energy Alliance.

  Trade and policy advocacy organizations that opposed the NPRM include the American Bankers Association, American Council on Renewable Energy, Center for American Progress, Citizens Climate Lobby, Public Citizen, and the Sierra Club.

To summarize, public comments received on the NPRM are overwhelmingly opposed across individuals (96%), investment-related groups (94%), and non-investment-related groups (57%). Non-financial trade associations are the only one of the 13 commenter types in which supportive comments (9) outweigh opposing comments (3) and mixed/neutral comments (3).

Key Takeaways from the Opposing Comments

We also wanted to know more about the arguments being made by commenters in opposition to the NPRM. Taken as a whole, we characterize the main points in opposition to the NPRM made in various comment letters, as follows:

1. **The NPRM is not based on evidence that a problem actually exists**.
   The NPRM did not establish that retirement plan fiduciaries are misusing ESG or that they are selecting investments that give up financial returns in favor of non-financial benefits.

   Putnam Investments, with more than $175 billion in assets under management, notes in its letter that the rule treats "all ESG approaches as if they involve intentional sacrifice of returns", but that purported harm to returns is "based on limited evidence" and overstates the purported problem. T. Rowe Price, with more than $1.1 trillion in assets under management, notes that "the proposal is premised on an assumption—unsupported by any cited facts—that ERISA fiduciaries are currently misusing ESG." Boston Trust Walden, with $9 billion in assets under management,

suggested that the Department do a thorough review of the literature that links ESG factors to financial performance, and Impax Asset Management LLC, with over $5 billion in assets under management, included an extensive list of over 320 studies that establish positive links between various aspects of sustainability and financial performance of both firms and funds.

2. **The proposed rule largely dismisses the financial materiality of ESG issues and ignores research regarding the materiality of ESG in financial decision-making.**
The NPRM contains almost no references to the significant body of research, including peer-reviewed academic publications and other detailed studies about the materiality and relevance of incorporating ESG factors into investment decisions, nor those that assess the performance of ESG funds relative to conventional funds.

The Defined Contribution Institutional Investment Association, with 166 members including asset management firms, investment consultants, and other financial institutions concerned with enhancing the retirement security of America's workers, states, "Members of the DCIIA community believe the Proposed Rule fails to acknowledge the many academic studies, research and industry reports that have found ESG risk factors are pecuniary, have shown improved investment performance when ESG risk factors are incorporated in the investment process, and have provided other financial-based benefits." Many of the letters reference the work of the Sustainability Accounting Standards Board (SASB), whose extensive work on the materiality of ESG factors and maps of those factors to specific industries and sectors is increasingly accepted by asset owners and asset managers. SASB counts more than half a million downloads of its materiality standards.

3. **The proposed rule is based on a flawed and unsupported assumption that ESG funds give up financial returns in favor of "non-pecuniary" rewards.**
Many of those who opposed the rule argued that the assumption that ESG incorporation harms funds' financial returns is simply unwarranted. BlackRock, with $7.4 trillion in assets under management, argues that "ESG data can be incorporated across asset classes in both active and index investment strategies to give a clearer picture of the financial risks and opportunities inherent in a portfolio." Its letter also notes that "enhanced data and insights make it possible to create sustainable portfolios without compromising financial goals. Our research, which relies on back-tested data, shows how ESG-focused indexes have matched or exceeded returns of their standard counterparts, with comparable volatility. We find that ESG has much in

common with existing quality metrics, such as strong balance sheets, suggesting that ESG-friendly portfolios could be more resilient in downturns."

4. **Rather than being subjected to additions burdens and restrictions, incorporating ESG factors into investment decisions should be considered a part of fiduciary duty.**
   Most of the those who commented on the proposed rule not only took exception to the rule's presumption that ESG factors were "non-pecuniary" and harmed returns, but argued that many ESG factors are material to financial performance and, as such, consideration of those factors should, in fact, be included in the concept of fiduciary duty.

   A sampling of the comments:
   - "It is our strong view that the Employee Benefits Security Administration should make ESG considerations a bedrock of fiduciary duty rather than discourage the practice." -- Legal & General
   - "The Department needs to clarify that, when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to consider them. U.S. investors are already considering ESG in engagement and investment decisions. The financial effects of ESG issues could manifest in the short, medium and long term. Because of the financial impacts and risks of ESG issues, and because ESG investments, on average, provide comparable or superior returns to non-ESG investments, it is a violation of fiduciary duty to not consider ESG in investment decisions". – Reynders, McVeigh Capital Management
   - "Our focus has never departed from an emphasis on the long-term financial prospects for the issuers of securities we hold. In short, we share the Department's view that certain ESG factors are pecuniary factors that should be considered by prudent fiduciaries as part of the mosaic of information they use in making investment decisions. We are not alone in viewing ESG considerations as important to investment decisions." -- T. Rowe Price

5. **Excluding ESG investments from Qualified Default Investment Alternatives (QDIAs) in Defined Contribution plans is inappropriate and could harm plan participants/beneficiaries**
   Noting widespread evidence on the materiality of ESG factors, commenters felt that exclusion of ESG funds from QDIAs was inappropriate and could hurt pension fund

beneficiaries. Plan fiduciaries should be incorporating ESG, not banned by regulators from considering it.

Putnam Investments, for example, noted that "Indeed, the Department now permits the use of private equity components within plan investment options, including qualified default investment alternatives (QDIAs). This action, which we support, seems to reflect a fundamental belief in plan fiduciaries' ability to assess and understand investments far more complex than ESG options. Based on the Proposal, an illiquid private equity investment strategy may form a component of a QDIA, yet a broad-based, liquid ESG-focused equity fund, competing against traditional investment benchmarks through investment in the stocks of large capitalization U.S. companies, cannot." State Street also echoed the sentiment, saying "Permitting the use of a prudently selected ESG fund as a QDIA is also consistent with the Department's QDIA regulation, which "does not identify specific investment products - rather, it describes mechanisms for investing participant contributions." Respectfully, we believe the same analysis should apply to ESG funds."

6. **Singling out ESG for a heightened level of scrutiny and restriction is inappropriate and unwarranted.**
   Many comment letters noted instances where "non-pecuniary" factors may be used in pension plans, but none except ESG considerations was singled out for exclusion or burdensome requirements.

   Perhaps the most striking example was noted in the letter from Fidelity Investments which has $2.5 trillion in assets under management. The letter noted, "Many plans offer company stock. Fidelity data shows that, as of 12/31/2020, 45% to 64% of corporate individual account plans with 5,000 or more participants offer company stock in their plan investment line-ups. Is a plan fiduciary required to justify the inclusion of company stock based solely on 'pecuniary' factors and, on a related note, what comparable 'available alternative investments or investment courses of action' would a typical fiduciary be required to consider?"

In sum, the NPRM has not shown that a problem exists that is in need of regulatory action, either that plan fiduciaries have been inappropriately selecting ESG investments or that ESG-focused funds have given up returns in exchange for "non-pecuniary" benefits. The proposal almost completely ignores significant research establishing the materiality of ESG and the competitive performance of ESG-focused funds. Based on the evidence, there is no reason to hold ESG to a higher level of scrutiny than other types of investments, nor to restrict the

consideration of ESG in retirement plans, in general, or in the QDIAs of defined-contribution plans, in particular. In fact, fiduciary duty ought to require the consideration of ESG in ERISA plans, not restrict it.

APPENDIX

Public Comments on U.S. Dept of Labor Proposed Rule, "Financial Factors in Selecting Plan Investments"

Commenters	# of Comments	In Support	Opposed	Mixed / Neutral
Investment Professional				
Asset Managers	86	1	85	0
Financial Advisors	46	2	44	0
Financial Service Providers	27	2	24	1
Asset Owners	9	0	9	0
Pension Plans	16	0	15	1
Investor Organizations	45	0	38	7
Trade/Policy/Political				
Trade Associations	15	9	3	3
Policy Organizations	45	18	27	0
Academics	17	4	11	2
Attorneys	14	2	10	2
Public Officials	17	6	10	1
Companies (Non-financial)	12	5	7	0
Individual	8,337	307	8,011	19
Total	**8,686**	**356**	**8,294**	**36**

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