COMMITTEE ON
EDUCATION AND LABOR
U.S. HOUSE OF REPRESENTATIVES
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WASHINGTON, DC 20515-6100

July 29, 2020

The Honorable Eugene Scalia
Secretary
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Secretary Scalia:

We write in strong opposition to the proposed regulation entitled "*Financial Factors in Selecting Plan Investments*" (RIN 1210-AB95).

Workers across the country are interested in investing in a way that reflects their values—whether combating climate change or promoting health and labor standards—without sacrificing returns. Environmental, social, and governance (ESG) factors enable them to be informed about potential risks and opportunities when evaluating an investment portfolio. There has been an uptick in assets in defined-contribution plans being directed toward ESG investments. In the United States, "mutual funds focused on sustainable investing attracted more than $20 billion in assets in 2019, more than 4 times the flows in 2018."[1] And there is little to suggest that investing in ESG leads to worse financial outcomes for investors. In fact, "a growing body of evidence suggests that using sustainable investments generally has not reduced risk-adjusted returns to date."[2] In May 2018, the U.S. Government Accountability Office (GAO) conducted a meta-analysis of peer-reviewed journals on ESG investing. GAO found that the "vast majority (88 percent)" of the studies found that using ESG information does not reduce financial returns.[3]

Over the years, the Department of Labor (DOL) repeatedly issued guidance regarding ESG factors and consistently ensured that plan fiduciaries exclusively focus on financial returns.

[1] Aron Szapiro, *Sharpening the Tools of the ESG Investor*, Morningstar (July 6, 2020), https://www.morningstar.com/articles/990232/sharpening-the-tools-of-the-esg-investor-morningstars-view.
[2] *Id*.
[3] U.S. Government Accountability Office, GAO-18-398, Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would be Helpful 7 (2018), https://www.gao.gov/assets/700/691930.pdf.

However, in instances when "competing investments serve the plan's economic interests equally well, plan fiduciaries can use such collateral considerations as tie-breakers for an investment choice."[4] This is commonly referred to as the "all things being equal" test.[5]

The proposed rule upsets the balance that decades of guidance sought to strike and needlessly erects barriers for ESG investing that do not exist for other assets in defined contribution (DC) plans. The proposed rule specifies that plan fiduciaries' evaluation of an ESG investment should focus solely on "financial considerations" that have a material effect on the risk and return of an investment.[6] The proposed rule indicates that it "is unlawful for a fiduciary to sacrifice return or accept additional risk to promote a public policy, political, or other non-pecuniary goal."[7] The proposed rule acknowledges that ties may "theoretically occur" when investments appear economically indistinguishable and imposes a new burden requiring the plan fiduciary to "document the basis for concluding that a distinguishing factor could not be found and why the selected investment was chosen based on the purposes of the plan."[8] However, the DOL clearly expresses doubt about the concept of "all things being equal," noting that it "expects that true ties rarely, if ever, occur."[9] Thus, in practice, "the burden of proof would appear to be on the side of the corporation" (plan sponsor) to adequately demonstrate that the investment was "outright superior" to the available alternative investments.[10]

The proposed rule also prohibits 401(k) plans from providing a qualified default investment alternative (QDIA) with an ESG component, even if it meets the pecuniary factor requirements. Meanwhile, the DOL recently took separate action enabling 401(k) plans to include private equity (PE) as a component of a diversified investment option, such as a target date fund (TDF).[11] Given TDF's stability and low cost, they often serve as the default investment option for many 401(k) participants. It does not make sense—nor serve the interests of retirement savers—for the DOL to propose excluding ESG investments from QDIAs while greenlighting the inclusion of high-risk, high-fee PE investments in them.[12]

Without a clearly defined problem that needs to be remedied, the proposed rule is a solution in search of a problem. The DOL failed to identify any litigation from plan participants or mention

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[4] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020) (to be codified at 29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.
[5] *Id*.
[6] *Id*. at 39113.
[7] *Id*. at 39117.
[8] *Id*.
[9] *Id*.
[10] John Rekenthaler, *The Department of Labor Attempts to Throttle ESG Investing*, Morningstar (July 2, 2020), https://www.morningstar.com/articles/990580/the-department-of-labor-attempts-to-throttle-esg-investing.
[11] News Release, U.S. Department of Labor, U.S. Department of Labor Issues Information Letter on Private Equity Investments, (June 3, 2020) (on file with author), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200603-0.
[12] The DOL points to a study "finding average expense ratio of 69 basis points for ESG funds compared to 9 basis points for broad-based S&P 500 index fund. In recent years, the asset-weighted expense ratio for ESG funds has decreased as ESG funds with lower expense ratios have attracted more fund flows than ESG funds with higher expense ratios." Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020) (to be codified at 29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.
In comparison, a typical annual management fee for private equity funds can be 200 basis points plus a 20% performance fee charged on the profits.

specific fiduciary breaches related to ESG investing that would necessitate the changes made by the proposed rule. In fact, the proposed rule acknowledges that "most fiduciaries are operating in compliance" with the Department's existing ESG guidance.[13] Additionally, the proposed rule does not cite any Employee Benefits Security Administration (EBSA) enforcement actions related to plans invested in ESG funds. Further, this issue was not included among the EBSA's national or regional enforcement priorities in the DOL's Fiscal Year 2021 budget or the three previous DOL budgets proposed by the Trump Administration.[14]

Although the proposed rule is both economically significant as defined by Executive Order 12866 and a major rule as defined by 5 U.S.C. 804(2), its regulatory impact analysis lacks the rigor that Congress and the American people rightfully expect to accompany these designations. For instance, the DOL failed to include any quantitative analysis on the costs to retirement savers in lost returns resulting from potential lack of access to ESG investments. The proposed rule mentions "small documentation costs" that plan fiduciaries would incur for complying with the rule; but it does not estimate what those costs would be nor explain what the DOL considers to be "small."[15] The DOL also failed to include any quantitative analysis on the benefits that would result from this proposed rule for America's retirement savers. Instead, the DOL merely offered an unsubstantiated claim that it "anticipates that the resulting benefits will be appreciable."[16] The DOL also stated without any supporting evidence or quantitative analysis that "[f]or plans and participants that would be affected by a reduced use of non-pecuniary factors, the benefits they would experience from higher investment returns, compounded over many years, could be considerable."[17] This is not sufficient, and it departs from how EBSA handled a regulatory impact analysis for another major rule.[18] In that case, EBSA published estimated costs and cost savings that they believed would result from the proposed rule.[19] Such detailed analysis is notably missing from the ESG proposed rule, which begs the question as to how it meets the legal requirement to assess all quantifiable costs and benefits to the "fullest extent that these can be usefully estimated."[20]

Amid the COVID-19 pandemic and a historic economic downturn, by proposing this rule, the DOL is undermining workers' ability to invest in a way that reflects their values without sacrificing financial returns. The DOL failed to establish a problem that needs to be fixed or

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[13] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020) (to be codified at 29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.
[14] *See FY 2021 Budget*, U.S. Department of Labor, https://www.dol.gov/general/budget (last visited July 22, 2020); *FY 2020 Budget*, U.S. Department of Labor, https://www.dol.gov/general/budget/index-2020 (last visited July 22, 2020); *FY 2019 Budget*, U.S. Department of Labor, https://www.dol.gov/general/budget/index-2019 (last visited July 22, 2020); *FY 2018 Budget*, U.S. Department of Labor, https://www.dol.gov/general/budget/index-2018 (last visited July 22, 2020).
[15] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020) (to be codified at 29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.
[16] *Id.*
[17] *Id.* at 39121.
[18] Default Electronic Disclosure by Employee Pension Benefit Plans Under ERISA, 84 Fed. Reg. 56,894 (October 23, 2019) (to be codified at 29 C.F.R. pt. 2520), https://www.govinfo.gov/content/pkg/FR-2019-10-23/pdf/2019-22901.pdf.
[19] *Id.*
[20] Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993), https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf.

provide a data-driven rationale. The DOL also failed to produce a rigorous economic analysis. Without such analysis, all Americans should share our concern and skepticism about the DOL's claim that the proposed "rule's benefits would exceed its costs."[21]

For these reasons, we strongly oppose this proposed rule and urge the DOL to immediately withdraw it.

Sincerely,

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[21] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020) (29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.

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